MERGERS & ACQUISITIONS | Roundtable

The role of technology in the evolution of the private equity industry

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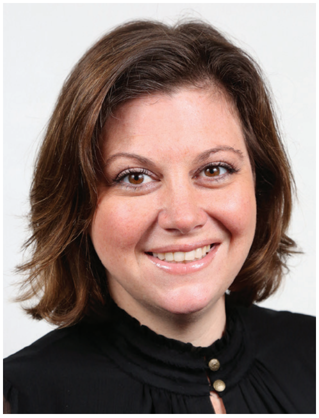


MODERATOR

Danielle Fugazy
Moderator, ***M&A***

As the private equity industry reaches maturity it has become increasingly difficult for private equity firms to get ahead of the competition. However, in an effort to get a leg up on the competition, many private equity firms are turning to technology. The strategy makes perfect sense: technology is known for creating efficiencies and streamlining processes in many industries. That said, while private equity is starting to adopt technology, the process has been slow despite the fact that various technologies could help generate out-sized returns that limited partners have come to expect. To discuss the issues, Mergers & Acquisitions brought together a number of private equity professionals. What follows is an excerpted version of the conversation, which explored what technologies private equity firms are adopting, how they are helping in the value creation process, what technologies PE firms are missing out on and what the impact will be going forward.

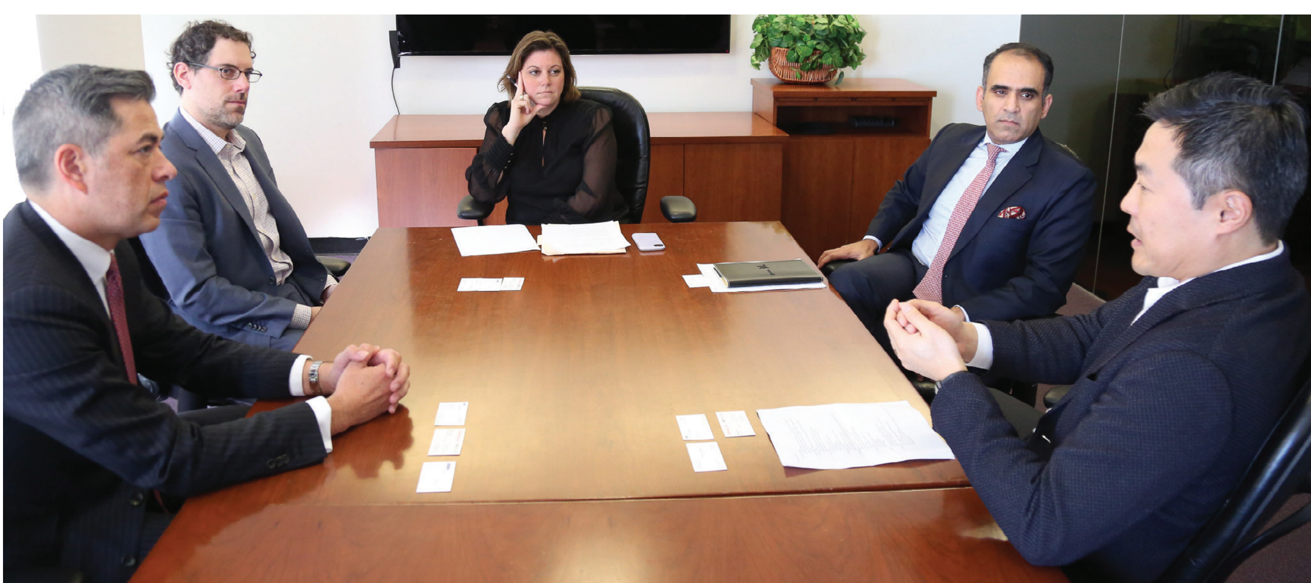
PARTICIPANTS:

Eric Feldman, Chief Information Officer, The Riverside Company

John Kim, Managing Director, H.I.G Growth Partners

Rich Lawson, Chief Executive Officer, HGGC

Rahul Puri, Global Head – M&A, Private Equity & VC Practice, NetSuite | Oracle



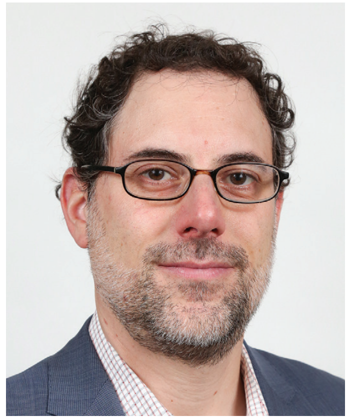
Danielle Fugazy: At the firm level, what role does technology play in private equity today?

Eric Feldman (Riverside): At Riverside, technology is essential to our operations. Within the company, there are many core platforms, which support all aspects of our business. CRM for our deal sourcing and fundraising/investor relations efforts, a proprietary portfolio company tracking and management platform and then our critical back office systems, which support departments such as fund accounting, human resources, marketing and compliance. Operating a fund in just Excel today isn't possible and having the capabilities and skills in place to support integrations for data modeling and analysis is very important.

Given the proliferation of cloud-based systems, having the right strategies in place is critical. In addition to defining internal requirements and considering critical touchpoints between disparate systems, the private equity world must wrestle with the changing regulatory and legal landscape. Where data is stored matters more than ever, which GDPR and other data privacy regulations have made abundantly clear. Limited Partners are also weighing in with standards such as ILPA to help create standard views of reporting data. Technology aligned with clear processes and procedures can introduce efficiencies to help private equity firms stay compliant and competitive. Technology is the foundation supporting all of this, but if not applied correctly or well thought out it will become a hindrance.

John Kim (H.I.G. Capital): At H.I.G. Capital, we are a big user of Salesforce. We took Salesforce and modified it to meet our needs. It helps us track deals and companies — not only current, but historical. Every company that we have contacted, whether it's through a banker or directly, is tracked. We have about 400 professionals scattered across two or three dozen offices in three continents so it is important for us to have a central repository that we can go back to and understand the different touch points that different professionals may have had with that company through time.

We also track our banking and deal source relationships through Salesforce. We assign an individual to each account. We track how often we call on them and how often they have shown us deals.



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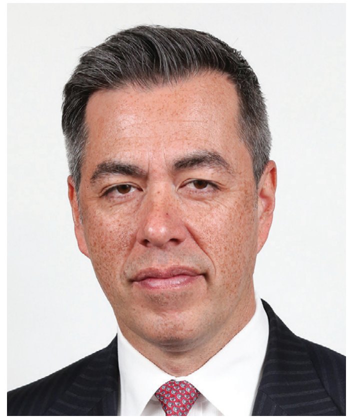
Rahul Puri (NetSuite | Oracle): Forget whether it is ERP, HR, or even fund accounting—we've seen a general investment trend moving more to cloud-based systems. There are a lot of the funds that are seeing their portfolio companies move from manual, antiquated, on-premise systems to a cloud-based system. And the funds are starting to say, wait a second, all this technology is available that we can implement quickly and efficiently and with minimal disruption? We have to use this ourselves. In the last year, there have been about 15 funds that we worked with to help them move from a very manual system to a more scalable platform like NetSuite.

Fugazy: Would you say you're seeing the majority of private equity firms moving toward using technology at the firm level?

Puri: We work with a lot of firms where they have two or three analysts working on just getting reports from every portfolio. They have 40 tabs in an Excel spreadsheet with at least 10 to 15 metrics that they want to track. Yes, you can spend $150,000 on an analyst to create that report and it will go out every Friday, every month end, every quarter, and at year-end. But by the time the data comes to me, is it real time and totally accurate? The technology and systems are now there and easily available to make this happen in real time with no errors. Now it is becoming cheaper, quicker, faster to deploy and I think that's what is driving a lot more adoption.

Feldman: Over the last three years, cloud solutions have really transformed how Riverside operates. Riverside is not interested in being in the business of hosting systems. It's not a core competency nor should it be. Leveraging cloud platforms, be it private cloud, software-as-a-service or infrastructure-as-a service, is the direction we are moving. The ability to integrate data across cloud services has advanced over the years making it easier to leverage well-defined APIs and pull data from multiple systems for report creation and analysis. Transition to the cloud is of interest to our portfolio companies as well. Gone are the days when a small company should be hosting their email infrastructure in a small closet within their office, for example, so transitioning to cloud-based services that specialize in this is our preference.



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Rich Lawson (HGGC): It is available now to every firm, so the question becomes how do you use that availability of data? I look at it in a couple different places, investor relations, our administration and fund level accounting, which we outsource. What I find fascinating in terms of building a private equity firm is that there was a time when we used to have everyone be responsible for relationships. We had created our own in-house database. What would happen is everyone would pile into it and there was tons of data, but it was really hard to figure out what was actionable. And then people would get busy on deals and they would forget to update it. User error always occurred for us. Instead, we ended up creating dedicated in-house groups. It was very challenging because most people on the deal side of the business want to own their relationship, but that creates an atmosphere of a bunch of independent contractors and that's not what we are. We are a firm. When we got to this point technology began to be very, very useful for us. Our dedicated in-house group is monitoring all inbound and outbound deal flow. I think we closed a transaction every 19 days last year. So the pace by which we've been able to accelerate our organization has really picked up. Early on there was too much information and it was not actionable.

Fugazy: How are private equity firms using technology at the portfolio level?

Puri: We work with all kinds of firms globally. Part of their investment thesis is driving value through add-on transactions. Many are focused on investing in firms that are founder or entrepreneur-owned, which probably haven't focused as much on the technology on the back-end. In the last seven years, the number of add-on acquisitions completed has quadrupled. As a result, a lot of private equity firms are now focusing on getting scalable infrastructure and how quickly they can add-on companies while making them efficient as soon as possible. We have about 40,000 entities running on NetSuite globally and as a result have created a best practice approach, which we call Suite Success. We can take any company in any vertical or industry and map out what the different best processes look like, whether it's the chart of accounts or lead to cash or procure to pay process. And here is the kicker: we can get the financials up and ready in 100 days – that's a game changer in the industry. This is a huge positive for the private firms we are working with. And it helps drive the usage of technology at the portfolio level as well.

Lawson: It's important to talk about this with your portfolio companies. A lot of our companies are trying to make these decisions in a vacuum. We have 77 various entities and they all have different ideas about who they want to use. We have already done the work and we own the relationships. Working with a couple of key vendors allows us pricing advantages and consistency. We encourage our portfolio companies to work with our relationships.

Just this past week, we did our sixth add-on in one year to a company. We doubled the size of the business with this acquisition and it was in Europe. With our relationships in place, it took us about 90 days to get up, on board and ready to go. I don't think that would have been possible 10 years ago.

Kim: For ERP software implementations, you're not only implementing software, you have to analyze your own business processes. There are best practices that come imbedded in the software, but there are some processes that you still have to customize. You either have to customize the software or you have to change your internal business processes to fit what's available from standard, off-the-shelf modules and that takes some time.

Also, a number of our companies are implementing cloud-based business intelligence (BI) tools. In the past, you had to establish an expensive data warehouse, which includes pricey hardware, and do a lot of data transformation to get some actionable insights. Today, companies have data in a lot of different locations, legacy platforms and databases. Having a BI tool that can take that data, normalize it, and then run sophisticated reports is a game changer. These tools have given our companies a lot of insight that they never had before. And it's enabled anyone in the company to run a lot of quick queries and reports as opposed to in the past you needed a very specialized analyst to do it. Getting these insights are going to be more and more important as companies try to compete in the ever-changing landscape where they have to get more and more data to help them understand which decisions to make.

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John Kim, Managing Director, H.I.G Growth Partners

Puri: I have definitely seen a lot of firms implement the BI tool. And you're right, those can be done in weeks not even a hundred days.

Fugazy: How easily do portfolio companies embrace your suggestions?

Feldman: My experience with Riverside companies is that they are very eager and excited that they have somebody that they can bounce ideas off of. They welcome suggestions and appreciate being able to save time. We own over 80 companies, all sitting within the lower-end of the middle market, and they are eager to learn and share with each other. I've spent a lot of time building a Riverside community where our companies can collaborate and share best practices with each other.

Puri: Private equity firms rarely mandate using their providers, but some strongly recommend it as they want to make sure that when their portfolios are evaluating they have some of the best-in-class as part of the mix. With that in mind, we have built relationships and we've signed non-binding Master Services Agreement that offer portfolio companies preferred commercials as well as focused implementation teams. For some of the lower middle market and middle market firms this is great as they can benefit from the pricing and also save time on negotiations. Internally, we have a Value Management team that builds out the ROI models which then makes the process of embracing the suggestions much more seamless.

Kim: In terms of embracing our suggestions, it's helping to run their business. Should your technology be optimized or re-platformed? We give them ideas, but part of why they may not embrace it is because they have to do a switch out while the business is still running. We can't tell them to put their business on pause, it takes time.

Lawson: You can have all these wonderful things, but if people are reticent of making those kind of investments then it's not going to go smoothly. One of the things we found very helpful is introducing great folks to come in and speak to our entire CFO group. We'll hold various offsites; I find that they feel it's very useful talking to someone that just went through that, or went through it three years ago, or is about to go through it at the same time they are.

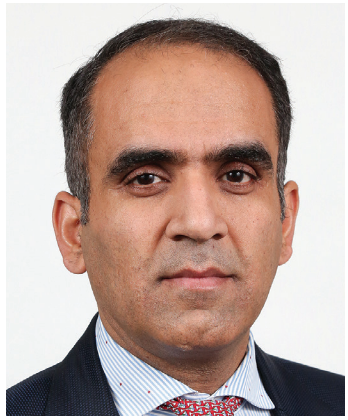
Kim: We do webcasts and have one of our technology partners talk about best practices and products/solutions. We discuss the capabilities of a partner so that management can understand whether the partner would be a good fit for them. It's important to take those best practices and learnings and share them with portfolio companies as well as the deal teams.

Lawson: For many of the portfolio companies it really helps when they find out there is a community.

Fugazy: How painful or painless is integrating new technology?

Feldman: Any kind of transition to a new platform is very painful. An extensive amount of planning has to go in to it. Even before you decide to evaluate a product, the question I tend to ask the companies is: What is the problem you are trying to solve? It takes time, energy, conversations with the right people and then going to market to make sure that 80 percent of the needs are going to be met by whatever platform you're putting in place. And then the really complicated part happens when you are moving from an existing platform that has its data structured a certain way into a new platform without disrupting the business. If you're a small company like the ones we invest in, the question becomes who is going to be doing all of that? A number of our companies opt to bring in external resources, such as a project manager, to assist with the bigger migrations. The project managers become the champion of the project. They understand business needs. They will be the interface between the business and the third-party. That's a good scenario. A mistake that some of our companies have made in the past is once they sign the contract, they assume that the third-party is going to make it all happen for them and that ownership internally is pushed to the side. In reality it is their data, it is their process, and they have to be responsible for it.

Puri: You can't totally eliminate the pain. You can definitely reduce it. As I said earlier, with our Suite Success methodology we share what the best practices for companies of your size and industry looks like. It shows that this is not first time this is being done – it's tried and tested, which results in reducing the pain drastically. I have GPs and CEOs and CFOs of companies coming to me and telling me that with this model the time to value has been reduced. They now know prior to even going in what great can look like.



"We can take any company in any industry and get the financials up and ready in 100 days… that's huge for any sponsor-backed company."

Rahul Puri, Global Head – M&A, Private Equity & VC Practice, NetSuite | Oracle

Kim: When any portfolio company thinks about making changes it's because they have current pain already. A lot of times when we invest, companies have proprietary software that is customized to exactly what they have today. It usually doesn't have the ability to scale as the company gets bigger. There is some limit to their proprietary software, so at some point they have to decide how to scale or re-platform on something that is commercially available. Hopefully, they will look to cloud-based solutions because it is easier to implement, but it means that they have to give up some of the things that they were used to. And that painful process of giving up those things and finding a software platform that best matches what they have today is a lot of work. It's never not painful, but you will be in a much better place afterwards than you were before and that is the reason why people make those changes.

Fugazy: Are any types of portfolio companies more accepting of the change and new technology?

Kim: I invest in tech and E-commerce. On the tech side, you would think that the technology company would be embracing new technology. But sometimes you have the "not invested here" thinking that prevents them from really exploring other solutions, whether they should be buying or outsourcing instead of making it on their own. For E-commerce businesses, they are constantly trying new things because you can quickly measure sales results. They do a lot of testing and look at the results whether it's seeing conversion rate increase, more traffic, or higher order values. These companies are constantly looking for new technology solutions as long as they are easy to integrate and stack.

Lawson: Sweet spot for us seems to be companies right in the middle market. Change is more difficult for the larger companies. It is really the medium-sized companies that have reached a certain scale that are asking you to come in and make an investment of time and resources. Companies in the middle seem to be very receptive to change. You would think smaller companies would be, but we do not find that.

Feldman: For the companies we invest in it's the first time they have partnered with a private equity firm and the reporting requirements, more often than not, helps to create a conversation around the utility of existing systems. The assumption after an acquisition is that some changes are inevitable, and we partner with, and encourage, our companies to think through how best to be more efficient and more precise. Our companies are generally open to change because most of them have yet to scale their technology footprints to keep pace with the demands of the business.

Puri: We are fortunate to work across different industries, size and geographies. I think historically manufacturing and distributions companies are the laggards in terms of adopting some of the cloud technology as compared to a software company, for example. Additionally, companies that are going through add-on acquisitions and realize that they need a scalable platform realize sooner or later that they need to embrace some of the new technology. There are three or four major reasons why companies are accepting new and changed technologies. First, changing business models. A lot of companies are moving to the SaaS model and their current infrastructure can't handle the change. Second, they are offering new products or expanding internationally. As sponsor-backed companies looks to expand, they need a robust system that can help them, especially if they are going international – consolidation and reporting becomes key. Upgrading is another reason. A large number of companies have antiquated systems and now need to upgrade and instead of using the same on-premise, they are looking at someone like NetSuite to get them to the next level. Add-on acquisitions is another reason. Companies know that they are going to grow through acquisitions and need a scalable platform and it is the same with carve outs.

Fugazy: Going forward, what technologies do you think will be winners?

Kim: The nice thing about the cloud is it helps you do acquisitions. When you make an acquisition, you can more easily switch the target company over to the platform company's cloud software program. Granular information becoming more available is also very powerful today. We call it big data, but the data has to be analyzed correctly. Machine learning is another technology to be watched. It's a fancy name for using software derived algorithms to come up with optimizations that help with a situation that might have not been conceived through human creativity.

Lawson: I would take a more general view which is technology is invading all of these different end markets. I find it fascinating that almost every company is a tech company today. We're finding that there are so many different end markets, such as insurance, grocery, retail and auto where you have businesses that are actually thriving because they're technology companies providing the tools to traditional players in those industries that are going to face significant headwinds in the next five to seven years. MyWebGrocer, for instance, provides the 'picks and shovels' to traditional grocers that are concerned about the emergence of Amazon in the grocery vertical.

There are a lot of neat middle market-type companies that are technology companies that are providing tools to traditional industries and players in those industries that are going to be in big trouble in the next five to seven years.

Feldman: Blockchain is one that many people are curious about. The fluctuations with Bitcoin over the last several months has created an interest and there are opportunities to ensure the companies we invest in understand the differences between crypto currency and blockchain technologies. This spring, Riverside is hosting a conference for our IT leaders and we're planning on having a speaker discuss opportunities for the use of blockchain across all different verticals. The intention is to present concepts and ideas which otherwise may not be obvious to everyone given the somewhat esoteric nature of blockchain. We're excited about this opportunity and are looking forward to seeing how it will benefit our companies.

Puri: Look at all these companies in North America; probably 60 to 70 percent haven't even embraced the cloud. I think for the masses just getting real time information to make decisions is going to be key. Cloud is here and has been here since NetSuite pioneered it in the late 1990s. We are going to see companies on a large scale embrace the cloud.

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