

***Venture Capital & Private Equity:
A Changing Model Requires Changes in Practice***

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Abstract:

The VC and Private Equity model continues to change. Most would agree that the industry has matured to the point of commoditization; forcing those that wish to compete on a high level to make better decisions faster. Not unlike other maturing industries, those that wish to compete in a commodity-like market are forced to operate on increasingly thin margins while at the same time adding more value to their customer in order to differentiate their firm from a sea of competitors. Like a distributor that innovates to provide value-added services to induce customers to look their way, the VC or equity managers must seek opportunities to add value to a product or service that may otherwise be perceived as a commodity and discounted accordingly. Forward thinking VCs and Private Equity Fund managers are looking *outward* to identify strategic big picture opportunities while at the same time turning their attention *inward* to innovate and improve business processes that add more value to the firm. Indeed, history shows that failure to respond and adapt quickly to changes in the business environment eventually leads to an irrelevant and outdated business model. This article puts forth several *inward* looking change opportunities and offers a framework of ideas that help add value to the VC and Private Equity model from a management perspective.

Dramatic change is currently underway-

One only needs to read the Wall Street Journal, Tech-Crunch or other relevant news sources to sense the considerable change currently underway in the Venture Capital and Private Equity investment industries. Growth in the Angel community, fee pressures and competition for deal-flow create challenges for some and opportunity for others. In 2008, Adeo Ressi pitched a provocative presentation to the entrepreneurship faculty at Harvard Business School titled, "The Canary is Dead" where he argued that the VC model was broken and that change was needed. Whether or not the proposed model worked or whether the model was indeed

broken to begin with remains a matter of perspective or a matter of opinion. However one thing remains clear: change is underway and it is moving at a blistering pace. As with most maturing industries, fund-managers are under increased pressure to compete on a higher level. In clear terms this means offering more value to the customer, making more intelligent decisions and doing it faster and better at a lower cost. In the VC or Private Equity world this means identifying solid investment opportunities on the front end, making judicious follow-on secondary investments and holding portfolio company executives accountable to deliver as expected. In short, this means

conducting the front-end investment analysis with added rigor, monitoring monthly portfolio-company performance with more diligence and finally, contributing value added management expertise when performance drifts astray.

Eliminating non-value added tasks; leveraging technology-

Embracing tools that leverage technology is vital to managing this process with a higher degree of skill and efficiency. In addition to reducing internal costs associated with acquiring, analyzing and reporting monthly portfolio company performance data; fund managers today must make greater use of their valuable time. Leveraging technology,

today's fund manager may synthesize and filter news and events collected from 80,000 data sources so that only data specific to their 30 portfolio companies is rendered through iPads and other mobile devices allowing for the ability to stay abreast of virtually every move in the market without wasting a single second. The ability to leverage mobile technology to analyze, read, write and collaborate with Partners in a closed environment positions fund managers that embrace such tools at a distinct competitive advantage.

Increase reporting transparency for decision makers and stakeholders-

Clear and transparent financial and portfolio company performance reporting to all relevant decision-makers up and down the stakeholder chain represents a major opportunity to maximize perceived value. The

need for transparent financial reporting to stakeholders including board of directors, investors, executive team members and lending institutions has increased dramatically in the recent past and especially so in light of the current global financial crisis. PriceWaterhouseCoopers, in a white paper that reviews current practices for the private equity industry states, "investors want regular and robust information and may exit funds if this is not made available". Clearly this statement underscores the need to provide stakeholders with reliable financial performance data and further illustrates that financial transparency is no longer a requirement for public companies alone. Perhaps more important is the need for fund managers and analysts to have easy access and insight into portfolio company performance to monitor trends and identify value

creation opportunities in order to manage and mitigate risk. Clearly, investment professionals can no longer rely on PowerPoint slides or spreadsheets to communicate performance, justify valuations or meet auditing requirements.

Valuation challenges continue-

Meeting auditing and valuation requirements while looking forward to the challenges associated with the impending convergence to IFRS standards will dramatically impact the need for consistent and reliable source of historical financial data. In particular, valuation methods that include a DCF component or earnings multiple require solid justification based on prior performance and historical variance to plan. Marking debt values that reflect a default premium may require a rigorous analysis of the company's

Driver	Opportunity
Inevitable Commoditization	Differentiate by leveraging technology to add value & improve decision making, mitigate risk and improve returns
Inefficient Data Management	Leverage technology and tools to economize the process of portfolio company performance data management.
Transparency	Turn growing need for financial performance and investment data into a knowledge-asset to facilitate future decision-making while creating a competitive advantage through superior reporting.
Auditing & Valuation	Implement technology strategy that results in consistent and reliable access to historic performance data to raise valuation and auditing processes to a higher standard.

financial position, underscoring the need for timely and reliable access to portfolio company performance data.

Conclusion-

No less than four significant trends continue to drive change with respect to front and back-

office management solutions. Industry leaders will continue to adopt technology to position their firms at a distinct competitive advantage.

Successful leaders will innovate with new strategies to retool and replace non-value added processes and activities with management tools that enable

better and faster decision making. Traditional modes of operation with respect to portfolio company performance management, valuation, and financial reporting can no longer support the demands placed upon the industry by investors nor can they meet the challenges of today's competitive environment.

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