



WHITE PAPER

DEBUNKING MYTHS: THERE IS NO SUCH THING AS A BEST PRACTICE IN INSTITUTIONAL AND ALTERNATIVE INVESTMENT OPERATIONS



INTRODUCTION

There is no such thing as a best practice in institutional and alternative investment operations. This is a bold statement, but based upon our experience as a technology provider to nearly 800 clients spanning the gamut of pensions, private equity, investment consultants, funds of funds, hedge funds, and more, it's true.

What we mean is this: there is no single best practice for a given business process within institutional or alternative investment operations. Rather, there are variations in investment and operations processes throughout the industry. Each organization has evolved its business processes over the years to optimize their operations, time, and resources. Therefore, arguably, whatever a successful business process looks like for that organization IS a best practice — for that organization.

Recognizing that best practices are variable has many ramifications for institutional and alternative investment and operations teams. One of the largest implications is in the area of technology selection. In other words, rather than forcing business processes to fit their operations software (and potentially losing the benefit of their best practices), institutional and alternative investment firms should force their software to fit their processes.

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3 PATHS WHEN SELECTING OPERATIONS SOFTWARE



BUY A POINT SOLUTION

You can purchase a point solution. This is a piece of software that does one thing and one thing only.

While this tends to be a lower-cost option, it is very limiting because the software does not permit your business processes to evolve as critical factors change over time.



BUILD YOUR OWN SOLUTION

You can build — either internally or via outsourcing — customized software that conforms to your business needs.

This is an expensive option, however, to create, maintain, and update if and when your processes change.



BUY A CONFIGURABLE SOLUTION

You can purchase software that is configurable.

In this case, the software contains a certain level of flexibility to adapt to your business processes. It is the best of both worlds, being cost-effective as well as agile.

As you consider what investment management and operational software would best support your firm, it is important to understand the different best practices that exist for investment and operational business processes across the industry. The best software option will support all of these variations of best practice, thereby enabling you to configure the software to optimally support your proven best practices of today, plus any new or modified best practices of tomorrow.

BEST PRACTICE VARIATIONS IN BUSINESS PROCESSES

Business processes vary widely across the institutional and alternative investment industry. Consider the following processes and how software must be configurable in order to support all the different best practices presented.



OPERATIONAL DUE DILIGENCE

How operational due diligence is addressed depends heavily on the type of clients a firm has and the resources they have available. For example, a private family office may focus on conducting basic operational due diligence and do so internally because they are limited by their resources (both dollars and manpower). The results of the due diligence review are not publicly available; they are accessible only by the members of the family.

In contrast, an endowment or foundation's approach to operational due diligence will likely be much more extensive because the information must be released to the public for scrutiny. The question then becomes, will this in-depth operational due diligence be conducted internally or will it be outsourced? There is no question of one approach being better than another — either can be a best practice for a given firm.

There can also be variations within a given approach. For instance, suppose two firms outsource the majority of their operational due diligence activities. One firm has general counsel in-house and the other does not. The one with internal legal support may want to perform the legal analysis first because, if the result is negative, there is no need to waste time or resources outsourcing the rest of the review. But the firm without internal legal support may choose to have the legal analysis completed last because it is an expensive task to outsource and they only want to complete it if everything else in the review process looks good.

Software that addresses operational due diligence, therefore, should ideally be configurable in a number of different ways. Namely, it should:

- **Support reviews that are basic as well as those that are extensive**
- **Be equipped to handle in-house and outsourced processes**
- **Be able to address task and timing variations within the process**

This configurability should extend to designing the flow of the desired process, creating the right alerts, establishing relevant controls, and automating review and approval by key stakeholders.



INVESTMENT REVIEW PROCESS

The investment review process contains innumerable opportunities for variations in best practices. For example, firms may evaluate areas such as strategy, risk, compliance, and more via an internal rating system, external ratings from consultants, and/or a proprietary scoring algorithm. They may focus on due diligence data points extracted from meeting notes and personal interactions with managers. They may rely on narrative commentary supplemented with quantitative analysis to drive recommendations. The investment review process — in whole or in part — may be performed in house or outsourced.

Because of the wide variations in best practices, firms need software that can collect, store, access, compare, analyze, report, and track data of many different types. This is a tall order, since much of the data in question may be unstructured data culled from meeting notes or narrative commentary. These software abilities are critical, however, as without them it is impossible to readily compare investments or evaluate their performance over time.

Software should support the various stages of the investment review process, the information collected at each step, and the approval processes required at key junctures. Additionally, it should be configurable to support the needs of the various teams that interact with the data gathered during the investment review process. For example, the operational due diligence team may want to compare data on certain fund managers. The research team may want to access the quantitative analytics conducted on a set of investments. The compliance or legal team may require access to key documents. All these teams have a different stake in the investment review process, and software that gives them the ability to accomplish their desired outcomes is crucial.



RESEARCH

Research at the strategy (product) level or vehicle level is a constant activity at institutional investment firms. But research can be conducted at varying degrees of granularity based on the criteria that different teams and processes require. Software should be configurable to support all these types and levels of research.

For example, if you have a very liquid asset such as a Standard & Poor (S&P) 500 portfolio, research may not be particularly deep. You simply want to know if a given manager has a reasonable track record “hugging” the S&P 500. If, at any time, you are not pleased with performance, it is simple to make a switch to another manager.

However, if you have an illiquid asset, such as a hedge fund, extensive research is called for because the fund is not exchange-traded and cannot be exited overnight. There could be one-year or even three-year lockups. You are, in essence, giving the hedge fund manager a much higher level of control over money than you are to an S&P 500 manager. You also might not have complete transparency into the hedge fund performance in real-time. For all these reasons, research becomes much more critical.

Private equity funds demand exceptionally intensive research because of the extended period of investment time and the harvesting period before gains are actually realized. If you're investing in private equity, the period for which your money is locked up is even longer than in hedge funds — it can be ten years before returns start coming back. Because you are giving the private equity fund a lot of money and a lot of time, it is essential that all available data be exhaustively reviewed before making a commitment.



BOOKS AND RECORDS

How an investment firm keeps its books and records is another area where best practices differ widely. First, firms may self-administer the books, which means they do not have an outside third party reviewing their custodial accounts. This approach requires a system of checks and balances, often supported by software, to confirm that recorded values are correct and that internal collusion does not take place.

Second, firms may “shadow” an external custodian. The custodian keeps the books and records, but the firm does so as well. The two sets of data can then be reconciled to confirm the numbers. This approach requires software that aids team workflows, provides processing capability, and integrates email and document storage.

Third, firms may rely on an external custodian or third party to track cash flow and net asset values (NAVs), but review and reporting is conducted internally. In this approach, software must be able to readily pipe data from the external source into the system.



SALES AND MARKETING/CAPITAL RAISING

Within the sales and marketing or capital raising arena, alternative investment firms can employ various strategies. For example, some firms focus on cultivating their existing network of relationships. This is particularly common for funds that are smaller in size or who have a niche-oriented strategy. Consistent contacts are key here, versus pipeline management.

Other firms rely on outbound marketing efforts based on the target profile for a prospect. These firms tend to depend on an external prospect database and have a strong need to integrate such data into their process flows for screening, outreach, and management across the sales pipeline.

Additionally, many firms — often larger firms or firms that frequently have new fund launches — combine these approaches to conduct business development efforts at scale. These firms require software that can help individual representatives manage their pipelines, while simultaneously providing visibility and oversight for a manager.

IS YOUR SOFTWARE TRULY CONFIGURABLE? HERE'S A CHECKLIST:



When evaluating software or constructing a Request for Information (RFI) or Request for Proposal/Pricing (RFP) for your organization, make sure you include the ability to do each of the following:

- ✓ Determine how each contact or entity is defined
- ✓ Configure fields and applications without vendor engineering support
- ✓ Define the data and behaviors of various entities
- ✓ Integrate with external data sources and processes
- ✓ Determine how various investments are to be evaluated
- ✓ Establish processes to align with your best practices
- ✓ Automate review and approval by key stakeholders
- ✓ Support collaboration between the various roles within your firm
- ✓ Monitor key processes and measure efficiencies and outcomes

WHAT TO LOOK FOR IN INVESTMENT MANAGEMENT AND OPERATIONS SOFTWARE

From the above discussion of business process best practices, it is clear that configurable software is of significant benefit to both institutional and alternative investment firms. If you are considering investment management and operations software for your firm, that platform will need to be flexible in the following ways in order to be configurable to your internal best practices:

- **Entities.** There are many types of entities that you may want to house in your system, and your software should be able to identify, house, and store relevant data about them all. For example, entities include investment vehicles (private equity funds, hedge funds, separately-managed accounts, etc.), organizations you interact with (vendors, custodians, consultants, etc.), investors, and investment managers.
- **Contacts.** All contacts are not created equal, and should not be treated as such. Different types of contacts will require the collection of different types of data and will prompt the initiation of different processes. For instance, investors will require one set of data, while vendors would require quite another. Or again, from a business development standpoint, some contacts will require compliance approvals to validate that the persons may be contacted to discuss investment opportunities, while others will not.
- **Processes.** Software should give you the flexibility to create your own processes based on entities, contacts, roles, and objectives.

Finally, the software you choose should be configurable by you. If it is only “configurable” by the vendor’s engineering support team, that is really just another word for “expensive customization.” But if you are able to readily configure the system to align with your best practices, you gain both control and agility. You will be able to make adjustments as your business or the marketplace evolves, and maintain operations at peak efficiency and optimization. And that is always a best practice.

ABOUT BACKSTOP SOLUTIONS


Because every minute matters, Backstop's mission is to help the institutional investment industry use time to its fullest potential. We develop technology to simplify and streamline otherwise time-consuming tasks and processes, enabling our clients to quickly and easily access, share, and manage the knowledge that's critical to their day-to-day business success. Backstop provides its industry-leading cloud-based productivity suite to investment consultants, pensions, funds of funds, family offices, endowments, foundations, private equity, hedge funds, and real estate investment firms.

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