KNOWLEDGE IS POWER IN PRIVATE EQUITY

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Leaders at private equity firms and funds might consider knowledge management a boring, back-office function. But if they are seeking a critical edge in sourcing and evaluating deals and creating value through investments—as everyone is—they should look to knowledge management to deliver a critical advantage.

That's because the emergence of new datasets, methods of analysis, intelligent computing power, and digital tools and processes is having a significant impact on investing. As complexity compounds in private equity's investment deal cycles, so too does the importance of sharing the best available data and insights across investment teams in an organization.

Indeed, our experience working with private equity clients to create what we call knowledge advantage indicates that funds that develop an effective knowledge management capability and ecosystem—and a firm culture geared to knowledge sharing—can realize significant competitive advantage.

In a representative private equity fund of about $20 billion in AUM, such gains would translate into a net impact of $20 million to $30 million annually. And a larger pension or sovereign wealth fund could see more than $100 million annually in net impact from effective knowledge management. We define net impact as the increase in investment returns achieved through enhanced decision making plus cost savings, and minus the costs of building and implementing the knowledge management infrastructure.

How Knowledge Management Creates Knowledge Advantage

Effective knowledge management drives an organization's productivity, enhances its quality of output, and increases its speed to market. Specifically, in private equity firms, it:

- **Reduces the duplication of research efforts** by providing firmwide access to commissioned internal and third-party research and industry publications.

- **Increases the efficiency of investment processes** by delivering instant access to relevant information and to the most relevant internal and external experts for a particular deal or situation.

- **Makes knowledge sharing more common and more transparent** by both breaking down internal barriers to information while also respecting the discretion of investment professionals regarding information that must be kept confidential.

- **Fosters a culture of collaboration** by gathering and leveraging knowledge through dynamic teaming and cross-team participation in investment and other decisions.

Crucially, effective knowledge management is associated with clear business outcomes, value to stakeholders, and return on investment. It delivers the tangible advantage of better investment and business decisions.

Once a knowledge management ecosystem is in place, investment decision-making processes leverage both internal and external expertise and proprietary and public information. They build on past learnings and on institutional memory. And they take advantage of curated insights on current and future trends and regulations across markets and sectors to generate new investment theses.

Knowledge Management in Action

The kinds of challenges that private equity firms can address through knowledge management are illustrated through the experience of a global investment management organization that invests for a major North American pension plan.

An increase in scale of the firm's AUM was accompanied by a shift toward investments in emerging markets. That is, the company began engaging in much more complex investments in a multivariate environment. Leadership knew that such a significant strategic shift would demand superior insight and execution. But examination of the organization's knowledge management capabilities revealed several weaknesses:

- Cost inefficiencies plagued the procurement of information. For example, duplicate research was commissioned by different investment teams.

- There was no transparency across departments on active positions and investment pipelines.

- No internal database could show which firm members had worked on which deals in the past or who operated in their external networks.

- No clear guidelines existed on which information could be shared among investment professionals. Indeed, very few incentives encouraged them to share and collaborate.

- All kinds of relevant information was siloed across legacy systems that were not easily accessible or searchable.

Such shortcomings are not uncommon among private equity firms, and we explore how the company in our example overcame theirs.

Overcoming these shortcomings requires thinking comprehensively about knowledge management, understanding how it can positively affect the entire firm, and building an ecosystem for creating knowledge advantage.

Building an Effective Knowledge Management Ecosystem in Private Equity

A knowledge management function is not a library. It is a dynamic ecosystem with three interconnected components: people and processes, content, and technology.

These three dimensions of a knowledge management ecosystem are mutually reinforcing. Each has some features that are universal and some that are unique to private equity.

People and Processes

Knowledge management teams come in all shapes and sizes, depending on the breadth and depth of knowledge capabilities that the private equity firm wishes to cultivate.

To develop an effective knowledge management ecosystem, a company must detail organizational and team structures as well as individual roles or functions, improved knowledge sharing processes for better investment decisions, and clear expectations for how investment professionals will capture, share, and reuse knowledge.

In Practice. In the example we cited above, the global investment management company appointed a knowledge leader to head up a newly developed knowledge management team. The leader and the team were given a mandate to help investment and corporate teams collaborate throughout the firm.

This mandate included working with investment teams to drive content curation such as the collection, navigation, and tagging of content, and to support virtual teams and forums in the sharing of knowledge across silos. It also included mining deal and research pipelines so that the company could "connect the dots" and facilitate introductions between investment and other professionals who might be working on similar projects.

The knowledge management team was validated as a true thought partner for the investment teams rather than operating merely as back-office support, and incentives and career paths were set accordingly.

Importantly, the firm also created specific, information-driven, standardized processes for compliance, including guidelines for information sharing and sanitizing, and access to such information across the firm.

Content

In private equity firms, knowledge management teams create detailed, smart-search directories of internal domain experts and their associated responsibilities as well as of external sector and topic advisors. Deals and positions are mapped by sector and geography.

Such maps capture so-called deal memory—that is, which individuals have led or executed such positions—as well as the current "owners" of the deal or position and any pertinent industry and market information.

In Practice. The global investment management organization in our example set out to create a content solution it called a "Collaboration Playbook." The playbook, which was initially created in an analog version to be digitized at a later stage:

- Mapped every deal conducted across the fund and detailed information about its "owners"—that is, the people who led the deal, who were currently responsible for it, or who worked as part of the deal team.
- Compiled a list of the fund's top positions and holdings across each sector and geography.

Technology

Private equity firms will derive the greatest value from a deep repository of fundwide knowledge by connecting it to a firmwide technology infrastructure. To ensure that employees can and do access the repository when they need it most, the collected information should be available on mobile as well as desktop and should be interactive.

An optimized data taxonomy and optimized metatags are required so that employees can retrieve information easily. But these features also serve as a customizable digital backbone for the data set that enables continuous improvement as new information, insights, and expertise are captured.

Blending efficient knowledge management with cutting-edge technology has been proven to be a strong tool for scanning and gaining early leads on potential investments. Scandinavia's EQT Partners, for example, uses the machine learning of its

Motherbrain artificial intelligence program to scan millions of start-ups and identify the most promising investments.

In Practice. Our example organization developed a mobile-enabled portal for information sharing and knowledge management. The portal served as a single destination for investors and corporate teams, enabling them to locate expertise within and beyond the firm's people and research and to map positions and deals (and the relevant deal memory) across the fund.

Getting Started in Creating Knowledge Advantage for Investors

Global investment funds currently take a range of approaches to encourage knowledge sharing and collaboration across their investing activities—from basic document retrieval and management to specific fundwide or firmwide forums for generating new insights.

Getting people to contribute content proactively and use any knowledge management tools that are developed requires changing firmwide culture and behaviors. Before undertaking this journey, private equity firms should ask the following questions:

- What is the state of knowledge management processes, systems, and culture in the fund or firm today?
- How could we generate the greatest value? That is, which content should we collect and share? How will knowledge management and sharing affect our different investment groups? Our core services?
- What specific tools, culture, and incentives will we need to be successful?
- How will we measure impact? For example, how will we attribute value generated by a successful investment decision to an effective knowledge management ecosystem?

The last question is particularly vexing since measuring impact is not an exact science. The calculation will vary from investment to investment, and indeed from firm to firm. Yet it is critical to understand the net ROI achieved by developing an effective knowledge management strategy.

Specific measures of impact could include detailed feedback from investment teams on the contribution (and utilization) of the knowledge management ecosystem in their deal processes, utilization of new resources and tools, cost savings on external research, and changes in employee behavior.

Implementation. Private equity firms must have a clear strategy for implementation. They should work in an agile fashion and look to achieve about 90% of targeted implementation within approximately two to three years.

Quick wins that deliver clear and tangible end-user impact will be important for building momentum and getting buy-in from investment and other teams that are likely to resist these new initiatives. At the same time, funds and firms must recognize the long-term nature of this commitment and act accordingly.

Success requires, first of all, securing buy-in from senior leadership across the fund or firm as well as within specific teams. It also requires making it clear to employees that the commitment to knowledge management is not just the pet project of a particular leader, team, or office.

Next, people from across the firm or fund should participate in a working committee to ensure the development of an ecosystem suited to the organization's specific needs. A phased approach to building out a knowledge management function should be considered. Although starting with small initiatives—such as the initial analog solution described in our example—may add complexity in the short term, it ultimately will reduce it over the long term.

Knowledge management is truly the next value frontier in private equity investing. It's a dynamic function directly relevant to something all investment professionals care deeply about: creating value through their investments and reaping the resulting rewards.

In an environment that grows more complex and competitive all the time, knowledge management deserves to become a top-of-mind focus for funds and firms.

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