

Digitalizing capital introduction: A pressing priority for prime brokers

Banking, Financial Services and Insurance



Abstract

For over a decade now, the capital markets industry has witnessed varying degrees of digital adoption. However, the pandemic has forced all capital markets firms to accelerate and reimagine existing processes through a new digital reality, especially for client-facing services. One such high-touch area is capital raising for hedge funds—the pandemic compelled firms to reimagine the entire process leveraging digital capabilities. Now, prime brokers are seeking a shift toward hosting virtual events and performing functions such as due diligence remotely to offer differentiated and efficient service to all stakeholders. As the industry gradually returns to normalcy post the pandemic, the capital introduction business will witness a further shift toward a hybrid model combining the best features of both high-touch and digital models. This white paper examines the need for a digital capital introduction platform to reimagine the capital raising journey from a hedge fund perspective. It also highlights the key business capabilities that can be offered on a digital platform.

Capital raising in hedge funds: The current landscape

The hedge fund industry experienced a massive uptake in 2021, reversing the downward spiral of the previous two years. Hedge funds attracted flows totaling USD40.9 billion in the first three quarters of 2021, after outflows of USD97.2 billion and USD44.5 billion in 2019 and 2020, respectively.¹ In our view, the hedge fund industry or hedge fund as an asset class remains attractive and will continue to see significant capital inflows from investors.

As part of prime services, investment banks offer capital introduction services to help hedge funds raise capital for new or existing funds. Prime brokers introduce hedge funds to accredited investors to raise capital. They leverage their deep investor network and industry expertise to connect investors and fund managers.

However, capital introduction comes with its own challenges, especially in the wake of the pandemic. The capital introduction service is high-touch, where prime brokers conduct events to bring together investors and fund managers to facilitate direct connect between these stakeholders. Remote working and social distancing restrictions have, however, constrained prime brokers from successfully hosting in-person investor events like roadshows and conferences—location, time, and cost compulsions limit their ability to attract a large investor base. Hedge funds, on the other hand, are focused on maximizing investor reach but at optimal costs, which in turn poses challenges to planning for an efficient and effective capital raising process.

[1] U.S. News, *Hedge Funds Set to End 2021 With Inflows for First Time in Three Years, December 2021, Accessed February 2022*, <https://money.usnews.com/investing/news/articles/2021-12-15/hedge-funds-set-to-end-2021-with-inflows-for-first-time-in-three-years>

A shift to digital

Given the challenges in the capital raising service for hedge funds, the industry is seeing a shift toward digital and witnessing varied adoption ranging from firms embracing digital for a specific function, for example, a virtual roadshow, to reimagining the entire capital raising process through a hybrid approach. Goldman Sachs offers online virtual introduction services, and over 900 hedge funds have signed up for the service. In addition, more than 600 investor firms have signed up, and the firm has made over 4,500 connections in the past nine months since the launch of the online service.² Consequently, other firms are under pressure to incorporate a digital capital introduction platform into their overall digital strategy to remain competitive.

Reimagining capital introduction for hedge funds with a digital platform

Advantages such as virtual connect between fund managers and investors, enriched digital capabilities, and end-to-end digitalization of the capital introduction lifecycle ranging from fund onboarding to capital raising and delivering a frictionless experience are spurring the adoption of a digital capital introduction platform. Figure 1 depicts the key benefits a digital platform brings to hedge funds.



Figure 1: High-level view of product value proposition and journey for a hedge fund

Established hedge fund managers seeking additional capital infusion have a lot to gain from this platform. Depending on the pedigree of the hedge fund manager, the platform can reduce the overall cycle time for raising capital, lower marketing costs, and offer frictionless access to known investors while enabling fund managers to reach out to new and larger pools of investors across different geographies.

From investors' standpoint, the platform offers a frictionless customer experience right from onboarding to investment in the fund without the need for in-person interactions with the fund manager. Investors also benefit from easier access to a wider choice of funds as well as high-quality research, a shorter investment cycle, and lower due diligence cost.

From prime brokers' perspective, a key benefit is the ability to remain competitive, thereby growing client base and revenues.

[2] yahoo! finance, Goldman's digital hedge-fund matchmaking push boosted by lockdowns, April 2021, Accessed February 2022, <https://ca.finance.yahoo.com/news/goldmans-digital-hedge-fund-matchmaking-051225696.html>

Key capabilities of a digital capital introduction platform

Prime brokers' capital introduction function is riddled with inefficiencies due to manual processes such as screening and shortlisting targeted investors for funds, screening and shortlisting suitable funds for investors, maintenance of documentation, and fund analysis and reporting. In addition, disparate systems like client onboarding and CRM systems are used to drive capital introductions. Adopting and integrating a digital capital introduction platform into the existing ecosystem can automate inefficient manual processes in the capital introduction function. Figure 2 shows a high-level view of the business capabilities that a digital capital introduction platform can deliver.

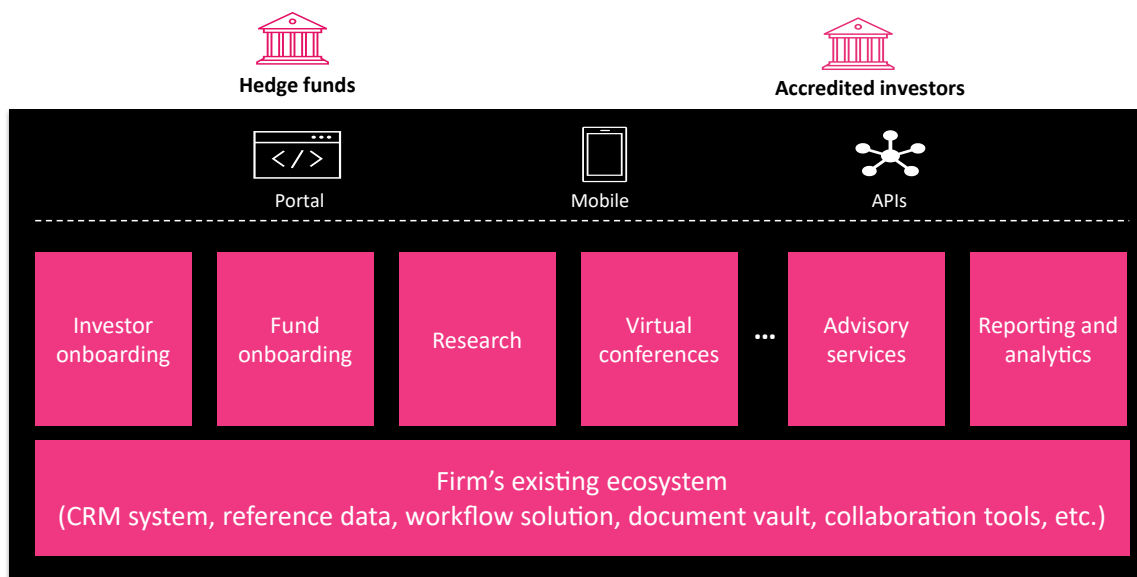


Figure 2: High-level view of business capability map of the digital capital introduction platform

Investor onboarding: Prime brokers onboard eligible accredited investors onto the platform, capturing investors' investment preferences, including key attributes like investment strategies, geographies, fund types, investment range, among others. These attributes combined with insights derived from artificial intelligence (AI) backed tools can help brokers to pitch the most relevant hedge funds, thereby improving customer experience and the hit ratio.

Fund onboarding: Hedge fund managers create fund profiles and relevant documentation, including the fund offering, agreement, and registration documents while onboarding funds. Fund profiles capture the funds' investment strategy, size, performance, and so on, which forms the basis for the platform to identify investors with a higher propensity to invest in the fund. Fund managers must have the ability to control access to the fund documentation and track its consumption across the lifecycle.

Research: Investors require access to a wide range of funds as well as documentation to identify investment opportunities. The platform must enable digital access to funds and documentation at the click of a button.

Host virtual conferences: Conferences can be scheduled to virtually connect investors and fund managers by equipping the platform with collaboration capabilities such as video-conferencing. Virtual conferences enable broader investor outreach and attract higher participation at minimal cost.

Apart from digitally enabling the aforementioned business capabilities, the platform should provide investors with the ability to perform virtual due diligence, connect with the fund manager through the preferred communication channel, request additional documentation, and so on. The investor should also be able to finalize the deal with investment commitment, submit the required documentation, transfer funds, and receive fund allocation information leveraging the platform.

Advisory services: The digital platform will serve as a single repository of market insights and collateral like due diligence questionnaires and templates. It will also arm prime brokers with the ability to control information access for fund managers. The availability of all marketing material in electronic form in a single repository enables faster completion of pre-marketing consultative tasks by a prime broker, facilitating a shorter time-to-market for new funds.

Reporting and analytics: The prime broker or fund manager can gauge investor interest by tracking investor activities such as downloads of fund documentation. Fund managers can then proactively reach out to such investors and convince them to invest when the propensity to invest is comparatively high. The platform dashboard can provide a summary view of key business metrics for all stakeholders. For example, fund managers can view their funds, capital raised, investor interest, investor events, and other information.

Looking ahead

With rapidly growing client demand for digital interfaces in every facet, a shift towards a hybrid digital business model for capital introduction services is emerging as an imperative for prime brokers. Prime brokers must think beyond virtual conferences and reimagine the entire capital raising function. With leading firms having launched or planning to launch a digital capital raising platform, firms adopting a wait-and-watch approach toward digitalization run the risk of losing significant market share and potentially becoming irrelevant in the market. To stay competitive in the market and achieve long-term success, firms must immediately embrace hybrid digital models in their capital raising function.

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Awards and accolades



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