KEYNOTE INTERVIEW

The growing importance of 'just-in-time' liquidity

Few data points are more crucial to a private fund CFO than current liquidity, and tracking that ever-shifting data is essential amid higher rates and volatile markets, says Hazeltree's Sol Zlotchenko

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For every blessing the digital revolution bestows, it exacts a toll. Cutting-edge technology can track all kinds of minutia, but users are still required to find the best way to sift through data for actionable intelligence. "Drowning in data" is a cliché, yet no one wants to sacrifice what that data could deliver: valuable insights that produce better returns.

The private funds industry has accepted that data management will remain a core discipline, and there are plenty of service providers willing to help, but no GP has unlimited time or money. As such, managers are forced to decide which data "issues" to prioritize. Given the ongoing uncertainty in the broader market, a firm's liquidity must be near the top of that list. *Private Funds CFO* sat down with Sol Zlotchenko, chief product officer and strategy lead for the private markets group at Hazeltree, to discuss how CFOs can track their liquidity at any given moment to make the best choices possible around capital calls and credit, even in the most challenging markets.

Q How has the role of the private funds CFO changed in recent years?

The CFO's role has changed by the sheer volume of transactions they oversee. Historically, they might have had to deal with a mix of say, funding events and some management company expenses, and although there may have been some complexity and tight deadlines, it was manageable.

We also didn't necessarily see the role of treasurer fully recognized by the industry. Today, the CFO is considered one of the firm's leaders, especially as their teams and mandates expand. They're involved in various mission-critical processes, including compliance, HR and IT, as well as managing liquidity, which requires a 360-degree view of their funds commitments, cashflows, investments and credit. Firms are managing more funds and those funds are often getting larger, with more investors participating from diverse geographies and, of course, that means more deals.

Suddenly, that role is not so manageable without a better set of tools. Traditionally, the private equity world didn't use as much technology as their public market counterparts, relying instead on spreadsheets and basic accounting platforms. However, over the last seven years or so, CFOs have been realizing that their current methods weren't scalable, and so they are seeking technology to industrialize their operations with a focus on automation and decision support.

Q As CFOs invest in modernizing their systems, what developments support the need to track liquidity more efficiently and accurately?

Interest rates started rising last year, and inflation continued to increase. That kind of fluctuation impacts a firm's liquidity. For a very long time, interest rates were so low that credit was used as the primary form for deal funding. Now, with interest rates going up, firms will need to strike a balance between credit and investor capital.

So, how does one determine the right source of liquidity at the right time? In funding deals, investor capital is technically free, but the systematic collection and reconciling of capital calls can be tedious and operationally intensive against a deal's deadline. At the same time, assets under management continue to grow, with that influx of capital bringing with it expectations of greater deal activity and bigger returns. This is all happening at a time when valuations remain volatile and exits are trickier to find and execute, stymying any manager's effort to deliver liquidity to their LPs.

None of those challenges are causing GPs to stop raising capital or pursuing deals. They're no less ambitious, but this environment makes it vital that they have accurate views of their internal liquidity at all times.

> *"Asset classes like private equity are not designed to have cash sitting idle"*

Q How does a CFO best track their liquidity in a challenging market?

They'll be frustrated if they rely on spreadsheets alone, and no one advocates throwing more staff at the problem. Most CFOs know they'll need to source best-in-breed, specialized technology to address all their operations, well beyond tracking their liquidity. As such, Hazeltree has built a comprehensive platform that operates in the middle and back office to help manage total liquidity and which lends itself to the idea of "just-in-time liquidity."

"Just-in-time" originally referred to inventory management in the supply chain and manufacturing industry, but for us it means managing and sourcing liquidity as needed in the most efficient way possible.

Q How does this idea of "just-in-time" liquidity work within the context of the private equity industry?

Asset classes like private equity are not designed to have cash sitting idle. Private equity investments require commitments from investors before deals are sourced, and capital is provided as needed. As a result, it is difficult to predict when funding is required, and challenging to determine the necessary amount of cash beforehand.

Our platform solves this by bringing in all the bank account data from around the world, all the credit facilities, all the cash on-hand, and all the investor commitments, and producing a snapshot of a firm's liquidity at any point in time. This allows a manager to see, in real time, a full picture of their cash, credit and investor capital and informs them of the best route to fund their deal. Clients can also stream future cashflows and liquidity events into the platform to provide a comprehensive understanding of a fund's liquidity position, both present and future.

This total liquidity picture allows managers to gain insights into their credit profile, available capital, and liquidity requirements and offers decision-support tools that can become an algorithmic framework for those decisions. It also offers the ability to issue and track investor notices.

Although relying on investor capital strikes a better balance in just-in-time liquidity sourcing, it brings operational challenges in tracking and reconciliation. We use machine learning technology to automate the process of matching investor capital calls to bank transactions, which helps reduce errors and streamline reconciliation. The technology can also predict and flag potential discrepancies in future transactions.

Q As with any new technology, CFOs will be sensitive to the cost and implementation challenges. How would liquidity tracking be integrated into existing processes?

We have built an iterative process so that our clients get some functionality within the first few weeks, and functionality builds over time. We also work with both fund administrators and in-house teams as it is crucial that new technology is compatible with existing systems. In some cases, we sit at the center of clients' technology platforms to help them deliver information to the various apps and systems in use. What good is a tool that can't be integrated into a client's processes? The platform is there to make a modern CFO's job simpler, not more complicated. ■