RESETTING FUND STRATEGY AND VISION FOR THE POSTCRISIS WORLD

By Markus Massi, Benjamin Sheridan, Ihab Khalil, Sergei Perapechka, Vinay Shandal, and Pratik Shah

EVEN THE BEST-LAID PLANS of senior leaders can go awry, especially when a major crisis hits. Principal investors who began 2020 with a clear strategic roadmap now find that the waypoints have shifted considerably. As a result of the COVID-19 pandemic, most investment activity has stalled or been redirected. Pipelines are in flux and deals that were once considered settled are being reopened and renegotiated.

The challenges are even more acute at the portfolio company level. Nearly every business has contracted, with some experiencing what are likely to be permanent changes in demand patterns. Most have suffered supply chain disruption, and virtually all face questions concerning their future viability. With exit windows temporarily closed, there are no easy answers.

As we mentioned in our first article in this series, principal investors have a unique opportunity to act as a steadying hand for their stakeholders, their portfolio companies, and their communities at large. With an eye to the recovery, fund leaders should use this period to reexamine the role they play in national economic development, rethink their deal origination and assessment processes, reengineer how they engage with portfolio companies, and rebalance their portfolios in light of what is likely to be persistent volatility.

In the normal course of business, few investors have the time to step away from their daily activities and engage in strategic soul-searching of this kind. Yet nearly all principal investors have unmet aspirations—including capabilities they'd like to acquire; sectors, asset classes, and deal structures they'd like to explore; and roles they'd like to play. Internal and external stakeholders may have their own hopes and expectations for the fund.

The COVID-19 pandemic has forced a pause. But the silver lining in an otherwise bleak period is the opportunity for fund leaders to push their thinking and determine who they want to be when the crisis abates.

Reimagining Fund Strategy and Vision

A strategic reset doesn't need to be—and, in our view, shouldn't be—a retrenchment. While the pandemic will almost certainly send major economies into recession, major funds do not have to contract in kind. Strategies may pivot, but the overall investment and capital deployment outlook should remain on a "buy and growth" footing—as is the case with Saudi Arabia's Public Investment Fund and the Qatar Investment Authority.

The reimagination exercise will differ across funds, depending on their mandate, investment strategy, risk philosophy, and operating model. We recommend that rather than exploring everything at once, funds take an incremental approach, so that management attention and resources are not diffused. Some funds may focus on repositioning their predeal activities from origination to opportunity assessment, others on reconfiguring their portfolio engagement models. Principal investors should involve supervisory institutions and key stakeholders in the reenvisioning exercise, where needed. Likewise, engaging with industry experts and seasoned investment leaders, and benchmarking with best-in-class funds, can be a helpful way to ground the strategic reassessment, providing funds with context on external opportunities and internal initiatives that have a greater chance of success.

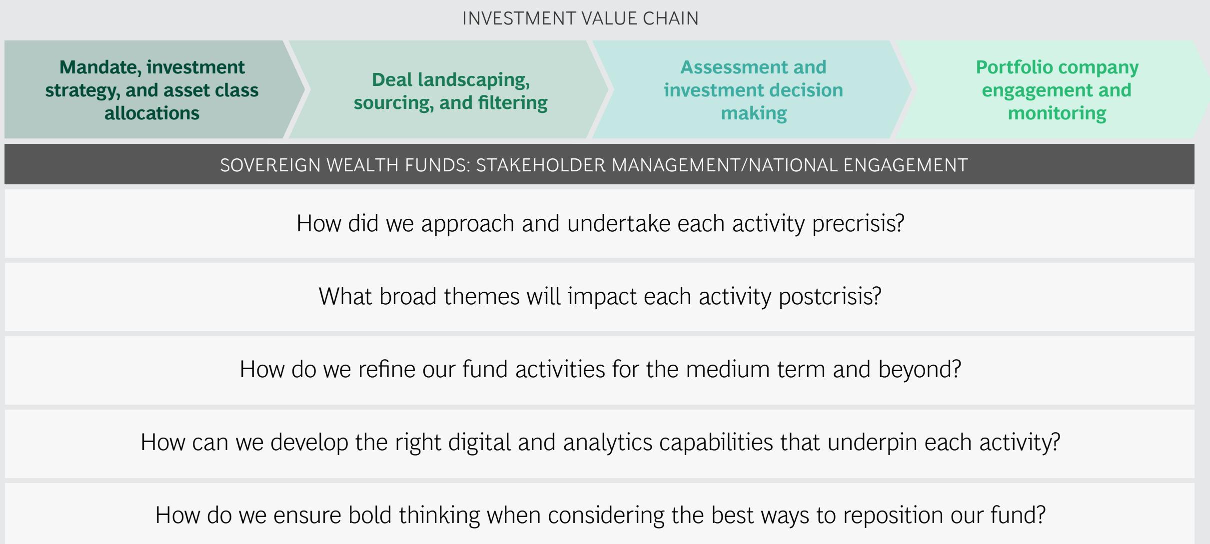
A Holistic Approach Is Key

What has been the guiding mission of the fund to date? And is that mission fit for purpose in the post-COVID environment? Answering those questions requires examining each link of the investment value chain and interrogating baseline assumptions. (See Exhibit 1.) Principal investors can then begin designing their target state.

Clarify the overall mandate, investment strategy, and asset class allocations. For some funds, the COVID-19 crisis could result in an identity crisis of sorts. Sectors and geographies that were central to a fund's vision at the end of 2019 may no longer be viable or attractive. Asset class allocations may need to be recalibrated, and mandates may need to be reconfigured. Leaders of principal investment funds will need to be specific and clinical in assessing these elements.

Fund mandates—be they financial returns and stabilization, wealth creation for future generations, or national economic development and diversification—need to be clarified and formalized. Related accountabili-

Exhibit 1 | Key Questions Funds Need to Address



Source: BCG analysis.

ties and future roles should be refined as well. (See the sidebar, "How Sovereign Wealth Funds Can Support National Stakeholders After COVID.") Importantly, fund leaders need to maintain a collaborative partnership with key internal and national stakeholders to prevent asymmetries in information gathering and decision making.

Funds will need sophisticated analytics and related processes in order to assess target investment sectors and asset class allocations dynamically and in real time. Success will require principal investors to dig deep *and* move fast. We recommend that funds model a sector's sensitivity to supply and demand fluctuations as well as its thematic relevance, given projected demographic or wider macroeconomic and market changes. Investors should similarly evaluate their asset class allocations and develop the analytics capabilities to model fund performance and portfolio scenarios in real time. Principal investors also need better sandbox capabilities to test potential excursions into unexplored sectors, asset classes, and capital structure opportunities. Scenario modeling that can simulate working capital financing, portfolio debt repurchases, and other situation-driven debt instruments can help funds refine their target asset class allocations and examine opportunities across a company's capital structure.

As a principal investor at one leading sovereign wealth fund told us, "In addition to running classic investment analyses of target sectors, we have started to conduct an in-depth assessment of the themes and trends shaping the world around us. That process is uncovering opportunities that we otherwise wouldn't have seen, and are now extremely interesting for us."

Diversify and strengthen deal landscaping, sourcing, and filtering. Principal investors have traditionally relied on investment banks and other financial intermediaries to originate opportunities. While that channel remains effective, funds will benefit from developing their own channels and relationships across target sectors.

Analytics that enable social media sentiment analysis, psychographic analysis, and other forms of pattern recognition, for example, can allow funds to track trends by segment, geography, and sector. This data can then be funneled into deal sourcing and filtering efforts. An investment team member at one sovereign wealth fund told us, "Before the crisis, we leaned heavily on investment banks and accounting firms to drive our deal flow. This worked for us, given that we didn't have a lot of internal bandwidth to drive deal origination. Things have since changed. We are now investing a lot more into data-driven capabilities to uncover new investment opportunities, especially social media analytics. We've even hired a person to help us in this area, with the aim of uncovering some hidden gems."

HOW SOVEREIGN WEALTH FUNDS CAN SUPPORT NATIONAL STAKEHOLDERS AFTER COVID-19

Government leaders and policymakers are facing a once-in-a-generation crisis. Sovereign wealth funds with a national mandate can play a key role in helping these leaders determine when and how to reopen their communities and stimulate economic activity. Given their considerable cross-industry and cross-regional breadth, insight, and operational expertise, these principal investors can also advise on long-range economic development plans—providing insight into high-growth sectors and transformative innovations. SWFs should use this period to meet with stakeholders and outline the best ways to partner going forward. For example, the SWF might choose to serve in a formal stabilization capacity or as a lender of last resort, providing companies with rescue financing or other capacity. Formalizing roles and the rules of engagement in a detailed plan can ensure more effective coordination in future crises.

In addition to tapping data, principal investors can improve the quality of deal flow by establishing dedicated business development teams (ranging from one person to a full-fledged team, depending on the capabilities needed) and aligning them with target sectors. These teams can serve as "scouts," tracking promising companies and building strategic relationships early, even before companies are in need of financing. Having sector-specific expertise will be especially important as funds consider expanding into nontraditional investment activities, such as debt financing. Ongoing networking will allow funds to keep an ear to the ground and gain a potential inside track should they later decide to advance to the deal stage.

Build assessment agility and digitize decision making, where possible. Postcrisis due diligence processes will invariably include multivariate tests that model a company's resilience to future shocks, in addition to traditional commercial and financial due diligence. To manage that increased load, funds need to acquire what we call "assessment agility," a capability that involves smarter analytics, more diverse teaming, and frequent experimentation. For example, deriving real-time, multilayered scenarios on companies and markets requires data analytics and assessment processes to be developed, either in-house or through a specialist provider. Likewise, building cross-disciplinary investment teams that integrate a mix of entrepreneurial, data science, and technology expertise can help funds review opportunities deeply and more incisively, speeding assessments and de-risking results.

In addition, as noted in our earlier article, funds must adopt, where possible, more efficient investment decision processes. A post-COVID recovery may return a semblance of normal business rhythms, but some degree of remote working and virtual collaboration will remain a fixture of the investment climate for the foreseeable future. To facilitate engagement—and address the issues that have made collaboration challenging during the quarantine period—funds must acquire meeting and workflow tools that will enable investment committee meetings and deal room brainstorming to be held virtually, with high-quality feeds and video, better workflow, upgraded security, and convenient access to all who need it. Funds may also use this period to consider streamlining complementary activities in their investment decision making so that more can get done in fewer steps. (See Exhibit 2.) Here again, digitization will play a key role, and start-

EXHIBIT 2 | How One Sovereign Wealth Fund Revised Its Strategy and Vision

INVESTMENT VALUE CHAIN

Overall fund strategy	Deal landscaping, sourcing, and filtering	Assessment and investment decision making	Portfolio company engagement and monitoring	
SOVEREIGN WEALTH FUNDS: STAKEHOLDER MANAGEMENT/NATIONAL ENGAGEMENT				
▪ Build distressed assets capabilities to take advantage of market dislocations ▪ Build capabilities in the emerging-markets financial services sector ▪ Rework mission to include joint financial and societal returns/goals	▪ Build proprietary origination channel ▪ Network with sector-focused experts (former C-suite) on potential opportunities ▪ Build CRM/deal platform to coordinate all deal-related activities	▪ Integrate data analytics and scenario modeling into commercial due diligence ▪ Reduce steps in the investment process to ensure rapid decision making on opportunities	▪ Build network of operating experts who can fill interim leadership roles in portfolio companies ▪ Hold frequent update meetings between investment team and portfolio companies ▪ Explore cross-portfolio knowledge-sharing opportunities	▪ Hold stakeholder meeting to clarify role in postcrisis national development agenda ▪ Deepen interaction with policy makers

Source: BCG analysis.

ing to build these capabilities now will help position funds for the medium term and beyond.

Reengineer portfolio company engagement models and monitoring frameworks. As part of their own fund strategy review, principal investors need to find a way to engage more actively with their portfolio companies, not only to address immediate operational and cash flow needs, but also to aid with strategic planning. The arms-length practices that may have been adequate before the crisis, such as limiting interactions to board meetings and the review of monthly or quarterly reports, will not be sufficient, given the acute needs that many portfolio companies are likely to face in the future. Building a specific, dedicated portfolio value creation team—or pushing existing teams to become more sector- and function-specific, especially with respect to digital capabilities, can help funds engage more closely and productively and reduce the strain on investment teams that are likely to have limited bandwidth in the postcrisis period.

The crisis presents principal investors with an opportunity to rethink their internal strategy and vision. Successful funds will do so holistically, in the context of their investment value chain, in order to validate whether their underlying strategies and processes remain fit for purpose in the aftermath of the pandemic. Planning for the medium term and beyond will allow principal investors to build resilient business and operating models that will protect and advance performance in the years to come.

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