E-BOOK

A bigger, more complex industry

Private Equity expert insights

What are the next 25 years likely to hold for private equity?

It is going to be an exciting time. The asset class has experienced tremendous growth over the past two decades, and we expect that to continue with increased allocations to private equity and illiquid assets.

This will partly be driven by greater numbers of entry points for retail investors emerging. Historically, private equity has been driven by institutional investors and large family offices, but we will start to see an increasing democratization of private equity so that the average person on the street can access the asset class.

In terms of trends, greater specialization among GPs is expected.

"The generalist buyout strategy is not dead, but there will be more focus on particular industries and even sub-sectors of industries, such as healthtech and fintech."

There will be more of a focus on specific countries, too, creating an opportunity to make more precise investments, enabling LPs the ability to allocate to certain geographies and industries via specialist managers.

The consolidation of the GP landscape will continue, with larger managers scooping up some of the smaller players through mergers and acquisitions.

We will see larger managers completing much bigger fundraisings in the next few years, too, as smaller managers suffer, because LPs will favor experience and track record during more challenging economic times.

Bigger managers will be the immediate winners through the recession, but many will be watching to see if that starts to change afterwards.

Larger funds are also likely to have greater capacity to deal with the increasing burden of regulation, possessing the required cash to invest in large compliance teams. Such investment is likely to be increasingly required, as government and regulatory oversight of private equity escalates in line with the growing numbers of retail investors targeting the asset class.

On the tax side, there is a convergence of tax systems within G7 countries, and that will have an impact on private equity as the advantages of some jurisdictions over others will emerge in relation to the likes of deal structuring. This may prompt a shift to more onshore structures than we have seen in the past.

What developments in technology can we expect to support the asset class?

Technology is becoming increasingly prevalent in investor portfolios, but so too is its use within fund management businesses.

The ever-present drive by regulators for more transparency is creating amplified demand for technologies that can capture investment data at the portfolio company level.

Once the data is captured, it is becoming imperative to report it quickly and clearly so that regulators and investors have a full view of an investment book.

On the front-office side, we are going to see greater levels of artificial intelligence being employed to help support investment decisions, as well as data and technology being used to make those decisions at a faster pace than previously seen.

The challenge for managers will be how they capture data and ensure its accuracy and veracity. The technology exists to support these decisions, but managers and portfolio companies need to get comfortable with the data capture stage.

More widely, technology is going to be used to a greater extent in investor services, investor relations and the client relationship management side of servicing.

Looking to the future, this will be used more than in the past.

At Apex Group, we spotted the need to provide a single-source solution that allows managers to log into a secure central point and have access to all their information, right from their investment data, performance, and scenario planning, through to ESG reporting and benchmarking.

One way to benchmark private equity's technological evolution is to compare it against banks, which have traditionally been ahead on the tech curve.

We expect that to change, and we see private markets getting to a point where everyone – whether they are an investor or a manager – has access to information and resources at the click of a button through a mobile app. That progress is going to be driven by service providers.

Do you see M&A driving positive change in the industry?

Ultimately, M&A activity at the manager level is going to drive consolidation, and we see signs of that activity increasing. That will give rise to larger managers with greater pools of capital and bigger investment teams, improving the ability to focus on returns to investors and efforts to make a positive impact as an asset class.

"Over time, large private equity fund managers are going to have the people, the capital and the scale to look insightfully at ESG and DE&I (diversity, equity & inclusion), which is maybe more difficult to tackle as a smaller manager."

Further downstream, they will also make greater use of their ability to leverage influence over portfolio companies, and therefore have the potential to play quite a significant role in driving positive change more broadly.

How might ESG and DE&I requirements evolve in private equity?

The pace and extent of regulatory change around ESG has been notable in recent years, but the starkest alteration has been the cultural shift.

We have seen a move away from ESG as a tick-box initiative to GPs structuring and driving their businesses around ESG strategies. That is not just driven by regulation, but also by investors.

More due diligence requests are emerging around the ESG components of private equity funds and strategies, and those are not just looking at the portfolio, but at the managers themselves.

At the GP level, investors now expect managers to walk the walk on diversity and inclusion, the environment and governance. Historically the focus has been at the portfolio company level, but this is now moving to the GP too.

While institutional investors are starting to look at this, as private equity enters the retail market and a new generation of investors comes into the asset class, that will shift even further.

These new Gen Z investors have been brought up with an understanding of environmental and social concerns, so that is a bigger part of how they view the world and how they are going to invest. It is only going to become more and more important for private equity managers to be able to be aware of these demands.

Do you envisage the expansion of access to private equity as being an important ongoing theme, as retail investors seek to allocate to private markets?

We are certainly seeing the increased accessibility of private markets being a theme, both in terms of retail investors coming into the asset class, but also with different geographies starting to invest in private equity.

In emerging markets, pension funds were largely invested in bonds 20 years ago, but as administrators and trustees have matured, they are increasing their allocations to asset classes like private equity.

That is a good thing for the asset class and a positive development for those jurisdictions in terms of diversifying their portfolios.

Broadly, there are going to be further implications of that accessibility on the regulatory side, because we are inevitably going to see increased regulation of private equity as more investors come in.

Because retail investors tend to have smaller amounts of capital to invest, fund structures will need to evolve to allow that access.

More hybrid structures holding both private equity and more liquid investments are emerging, with platforms now enabling managers to hold a mixture of asset classes that suits different types of investors.

As a single-source solution service provider, we are developing a product offering that brings together the expertise from both liquid and illiquid asset classes.

Are current recessionary trends increasing appetite for outsourcing? How do you expect that demand to evolve over the next two decades?

Given the recessionary trends, the outsourcing model is increasingly popular because it allows managers and funds to cut their cost base and manage their operational risk.

We are noticing a growing trend towards outsourcing as a means to take some of those larger costs off the balance sheet, which is a smart move from a risk perspective.

Managers want to focus on their core investment capabilities, which means making strong decisions on behalf of investors. They increasingly want to pass anything beyond investment management on to a trusted service provider with whom they have a relationship.

There is also a burgeoning preference to work with a sole provider that can deal with the full range of fund administration tasks.

Elsewhere, speed to market remains key in being competitive. Service providers that offer digital banking solutions speed up various processes, including anti-money laundering and Know Your Customer checks required when client accounts are being opened.

With the uptick in crypto and digital assets, managers want to work with established providers that already have a solution in place, so they are able to launch and go to market much faster.

Managers are increasingly focused on technology, but they want innovative solutions to be backed by a secure infrastructure. Outsourcing firms need to be a sufficient size to support that infrastructure while also continuing to meet ongoing regulatory requirements.

The long-term trend is towards further outsourcing, and we expect a recession to accelerate that.

In turn, alongside the consolidation taking place at the GP level, there is continued consolidation among service providers. We see the power of consolidation and how this supports global managers that expect their providers to be available in multiple jurisdictions, able to support them with cross-border capabilities.

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