Will seeing what lies beyond bring new opportunities into focus?

Strategic leaps are creating new pathways for value creation for private equity firms

2022 Global Private Equity Survey

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“

We would like to express our appreciation to the 107 private equity COOs, CFOs and financial executives who offered us their valuable insights and observations. We believe these insights will assist stakeholders in making informed decisions as they continue to evolve into the private equity firms of the future.

Chris Smyth, EY Americas Private Equity Leader
Kyle Burrell, Partner, Financial Services , Ernst & Young LLP
Andres Saenz, EY Global Vice Chair – Industry Markets

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EXECUTIVE SUMMARY

The value of private equity continues to rise as firms take another strategic step forward.

Private equity and venture capital firms have never been as valuable as they are right now. Like any desirable asset, its owners must take steps to protect it and put infrastructure around it to maximize value. As it relates to private equity and venture capital, owners of the firms have now started asking questions like, "What is the value of our firm in the marketplace?" and "Is the next decision I have to make regarding the firm's business the right decision?"

The answers to these types of questions often reside in the underlying data of the business as well as its competition. Chief financial officers (CFOs) of private equity and venture capital firms have continued to be regarded as strategic members of the business and as the stewards of this valuable data. Owners have been never more reliant on CFOs to provide reliable information to the business owners to help them make informed decisions that will continue to enhance the valuations of these firms. In light of this, CFOs have deployed an infrastructure regarding reporting and established financial planning practices to support a careful analysis of their businesses.

For years, CFOs of private equity firms focused on making sure the core business was running smoothly through managing funds efficiently while allowing the investment professionals to identify and then acquire target companies. Above all, they pursued a common goal of achieving sustainable asset growth.

To that end, private equity firms made significant investments to automate processes, upgrade back- and front-office talent, and expand product offerings. Their efforts building this foundation paid off when they had to navigate the initial challenges of the COVID-19 pandemic. Virtually overnight, most firms shifted to a remote working environment while continuing to raise capital and identify target companies.

For the most part, firms didn't miss a beat during the pandemic and are now capitalizing on a robust capital market, which saw more than $1.1 trillion flow into the private equity industry in 2021. As they continue to grow, more private equity firms are embracing the next wave in their development, strategically building out more rigorous operating models for their management companies that often put them on par with larger financial institutions.

This push toward a more mature operating model for the management company was one of the key findings in our 2022 Global Private Equity Survey.

The output of this strategic thinking has been two-fold; make informed decisions to protect the established brand and continue to look for ways to grow. Creating long-term value through a well-thought-out talent management plan and incorporating environmental, social and governance (ESG) considerations are two increasingly important initiatives deployed by many private equity and venture capital firms. Among other survey results, firms continued to expand their efforts to attract and retain workers, adjusting to the impact of the pandemic by offering hybrid working arrangements. Our survey also uncovered the steps they are taking related to ESG products and, cautiously for now, cryptocurrency to offer a broader range of product offerings to attract new capital from investors.

In some ways, this forward step in maturity is part of the natural private equity life cycle as more firms evolve from smaller organizations managing a handful of funds into larger, more complex financial institutions with responsibility for multiple portfolio companies and the growing alternatives allocation from investors. Moreover, with so many company valuations at all-time highs, this new rigor is also a strategic necessity as the risks of making a bad decision or missing out on an opportunity can have enormous consequences in this competitive environment.

We highlight the survey findings on the following pages.

CHAPTER ONE

A STRATEGIC FOCUS ON THE BUSINESS

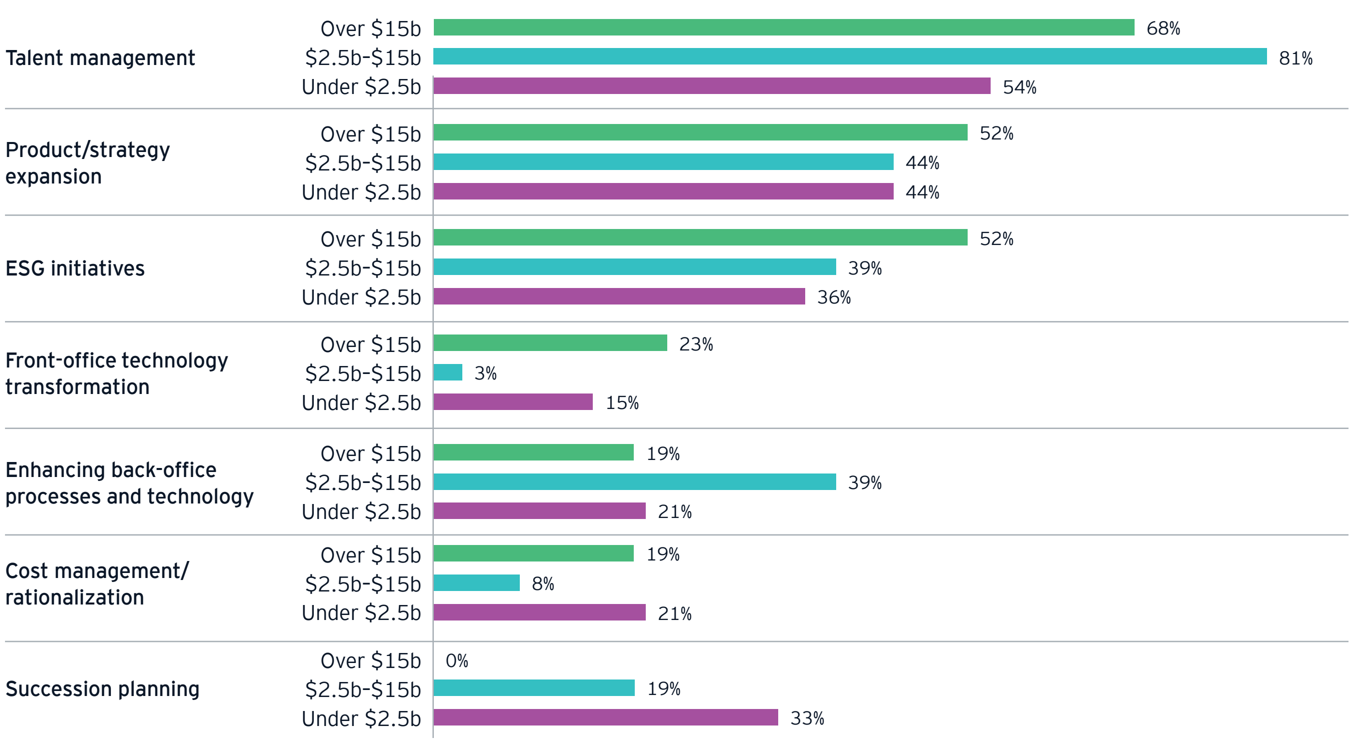
As increasing amounts of capital flow into the private equity space and firms are seeing high multiples paid for private equity business, fund managers realize the stakes of making the right choice are growing exponentially higher.

In the past, companies might have been able to afford to back the wrong company, but with so much competition for increased deal activity and media scrutiny on private equity, the risks of making a mistake are huge. On the flip side, making the right decisions could lead to major benefits for the firm, both in enhancing investor confidence and overall long-term brand value.

That's why many private equity firms are moving to adopt more mature business processes, from internal reporting and compliance to fully developed financial planning and analysis (FP&A) functions. While larger firms, those with in excess of $15 billion in funds, are leading the way, all firms are stepping up their game as they keep pace with the larger players in this space.

This shift toward a more institutional mindset is reflected in the 2022 survey results. In the past, CFOs cited operational concerns relating to the funds, such as enhancing back-office processes and management and implementing technology, as top of mind. This year, besides asset growth, the top three strategic priorities listed by private equity firms are talent management, product and strategy expansion, and ESG initiatives and offerings. This reflects the fact that more CFOs believe they and their teams have adequately addressed these back-office issues by building out infrastructure and creating a scalable operating model.

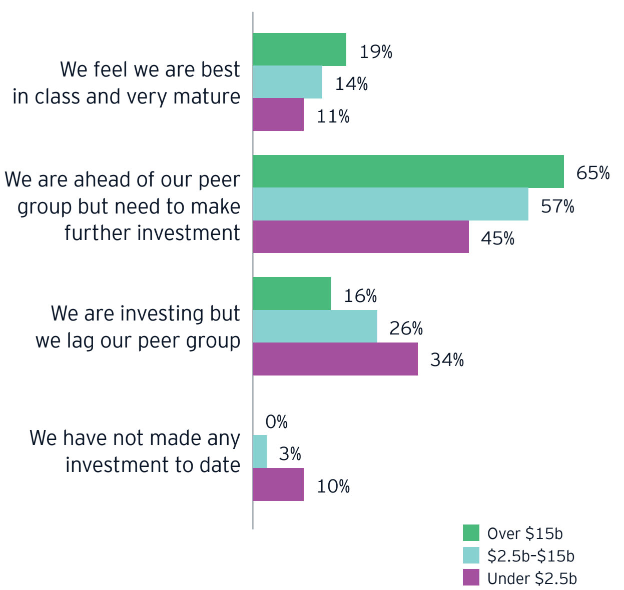
What are your top strategic priorities aside from asset growth?



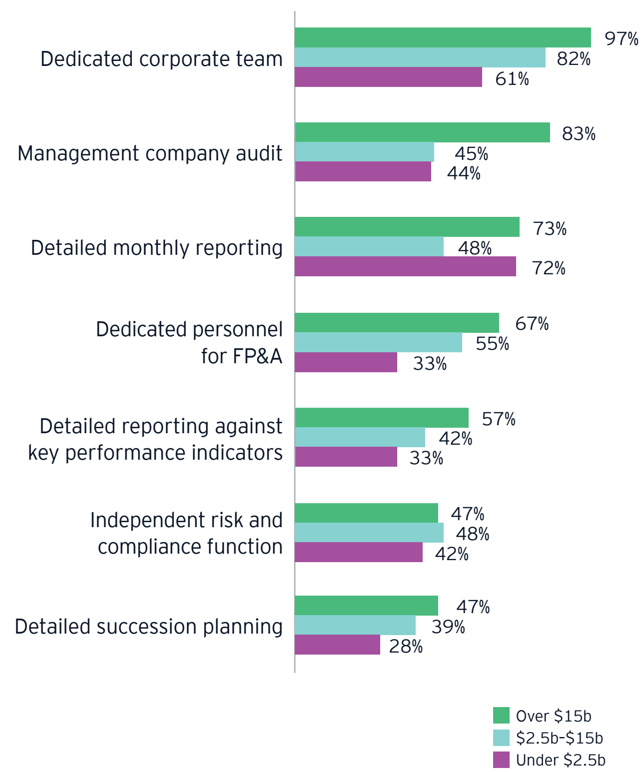
When asked to rate the institutional maturity of their management company, 84% of the largest fund managers said they are generally ahead of other managers, compared with 71% of midsized fund managers and 56% of smaller firms. Fund managers were less likely to say they were best in class, however, with only 19% of large fund managers, 14% of midsized fund managers and 11% of smaller firms considering themselves as best in class. This seems to indicate that although managers feel relatively comfortable with their management company operations today, there still is room to mature and take a step forward.

In the past years, many management teams handled a wide range of responsibilities that reflected an all-hands-on-deck approach. Now, nearly 97% of the largest firms said they have teams dedicated to overseeing corporate operations. While smaller firms lagged a bit on this question, they have clearly realized that private equity firms require someone to have oversight over all key business functions. Other survey results reflect this understanding, from detailed monthly financial reporting to dedicated personnel performing FP&A. This is not surprising given the necessity to use all available information to make more informed decisions about the path forward.

How would you rate the institutional maturity of your management company?



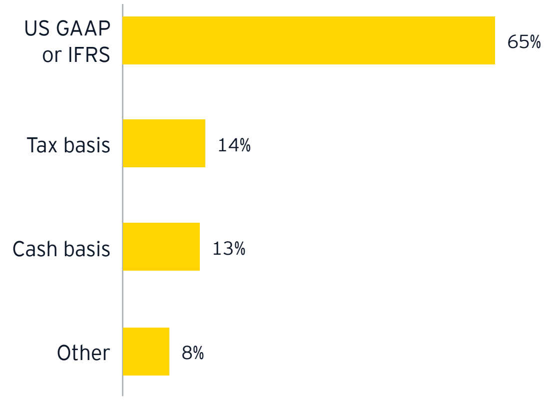
What do your management company operations look like?



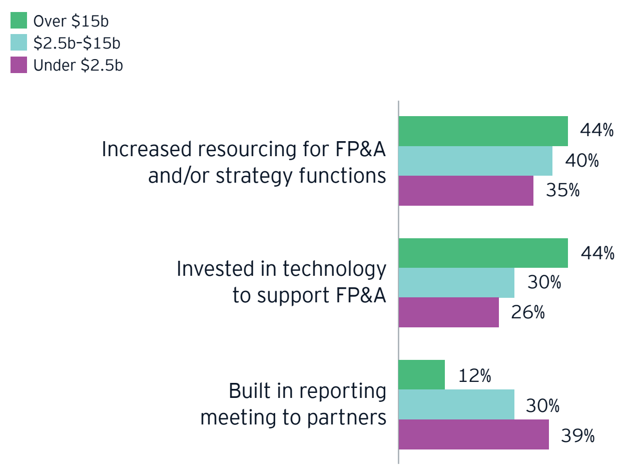
In previous years, accounting and reporting for the management company lagged in importance to the funds. Historically, management companies were owned by a small number of founders with little external investment. Today, management companies are fielding inquiries about equity investment, accessing the public and private equity and debt markets, and evaluating the best-case scenario for succession planning. In line with the maturation of other parts of the management company, nearly two-thirds of all firms say they now use US GAAP or IFRS as the primary accounting and reporting basis for their management company.

Further reflecting the sharpened focus on building out a broader set of processes at the management company level, more than 43% of the largest firms said they had significantly increased their investment in people, processes and technology over the past two years. Midsized and smaller companies were less like to say they have, but roughly one out of five said they had increased their investments significantly, 19% and 23%, respectively. Building out these processes has allowed for more informed decisions to be made by the growing firms and no longer are decisions made by "taking a gamble."

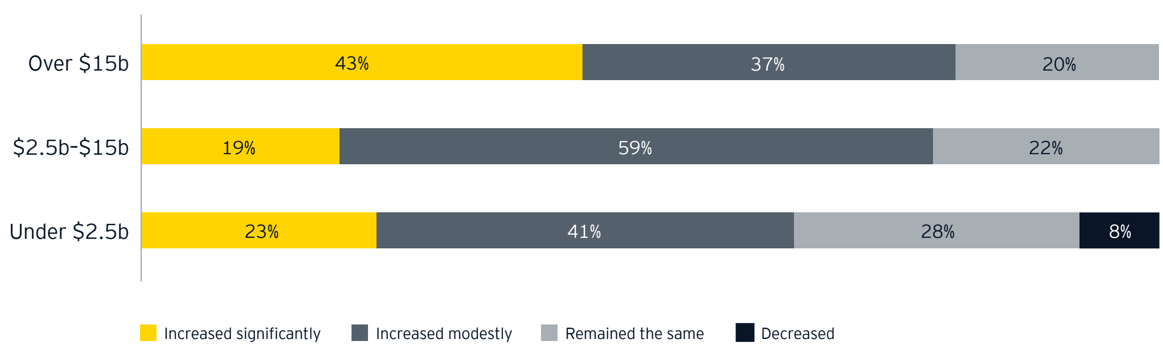
What is the primary accounting basis for your management company?



What was the most impactful change you've made to your management company functions in the past two years?

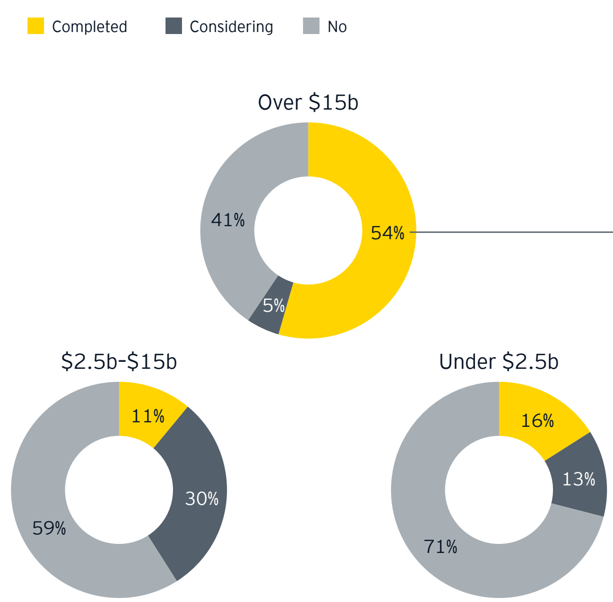


How has the investment related to your management functions changed in the past two years?



Not surprisingly, given the increased valuations reflected in transactions for private equity and venture capital firms in the past year, increasing numbers of fund managers are contemplating exit strategies, such as an initial public offering or a merger and acquisition with another firm. Some 54% of the largest firms surveyed said they had completed a strategic transaction in the past several years. Of those firms that had completed a strategic transaction, 56% said they have acquired another firm to add value to their private equity platform, while 31% had sold a noncontrolling interest in their management company to raise capital. Others said they had engaged in debt financing to expand operations and deal with succession planning. Where exits were typically thought of at the portfolio company level, a focus on the private equity firm's own value is of utmost importance. At a minimum, the most mature firms have already started a process to understand their balance sheet and valuation to the market and are informing owners of potential monetization scenarios if, and when, they believe that is in their best interest.

Has your management company completed a strategic transaction in the past few years?

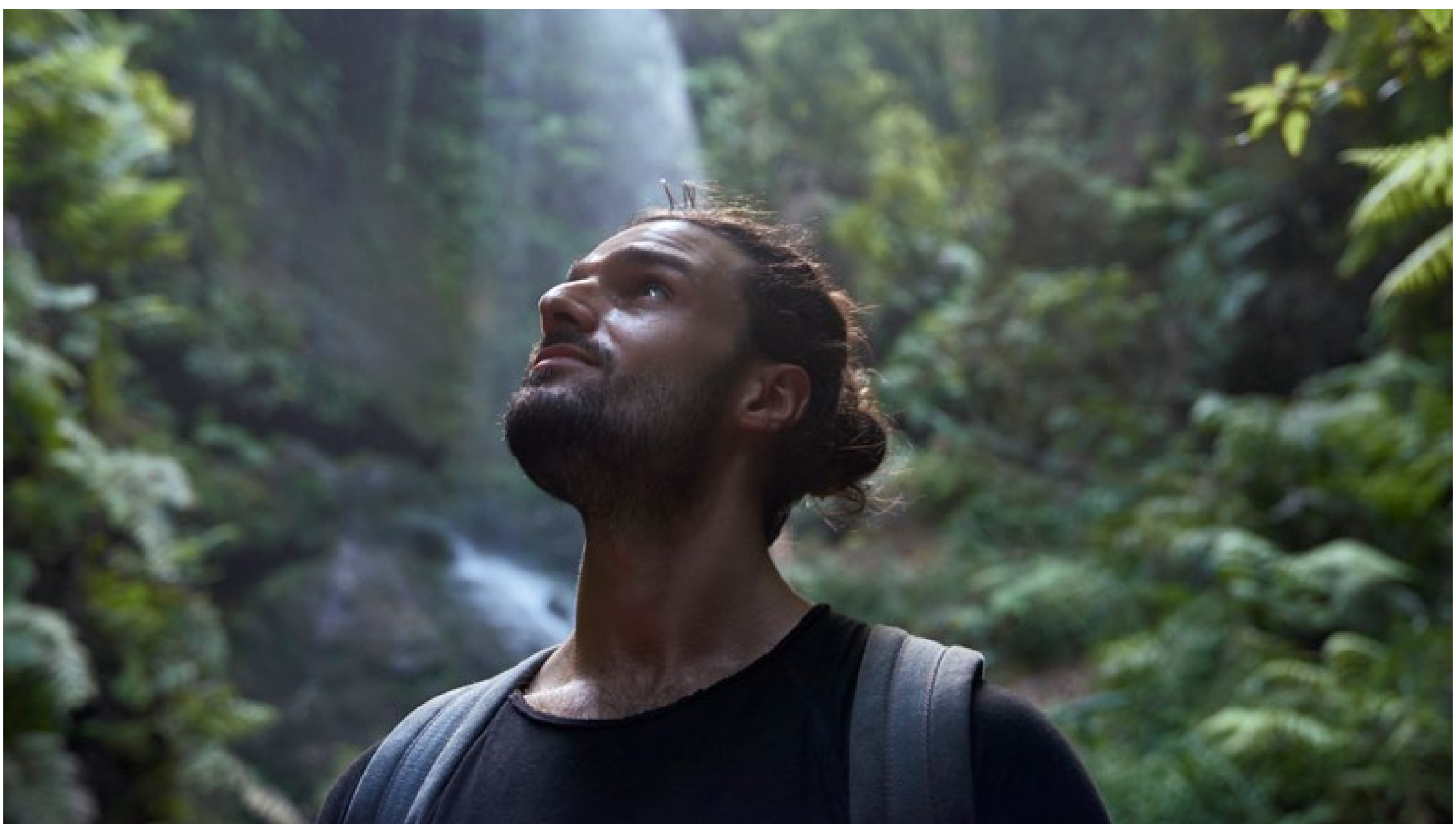


If completed, what type of transaction was it?

Just like most public firms, keeping an eye on margin is always important. Although top-line revenue has been growing for many private equity and venture capital firms over the past few years, firms have to understand the impact of their spend. Firms reported that they had taken a wide range of actions in their ongoing fight to mitigate margin erosion as costs continue to rise. On a positive note, many indicated that the benefits of prior technology implementations were helping them curb costs. Among the largest firms, 63% said past technology deployments were still paying off, while 40% of midsized firms and 37% of smaller firms said those actions were still helping them reduce costs. The COVID-19 pandemic continues to provide firms with an opportunity to evaluate the costs related to office space and travel.

Which actions have you taken to mitigate margin erosion at the management company?

	Over $15b	$2.5b–$15b	Under $2.5b
Deployed new technology	63%	40%	37%
Increased outsourcing	38%	47%	47%
Renegotiated fees with vendors	38%	37%	37%
Reduced amount of office space	33%	7%	23%
Reduced travel and entertainment budgets	21%	13%	17%
Added junior talent in lieu of senior hires	17%	23%	33%
Reduced headcount	17%	10%	20%



CHAPTER TWO

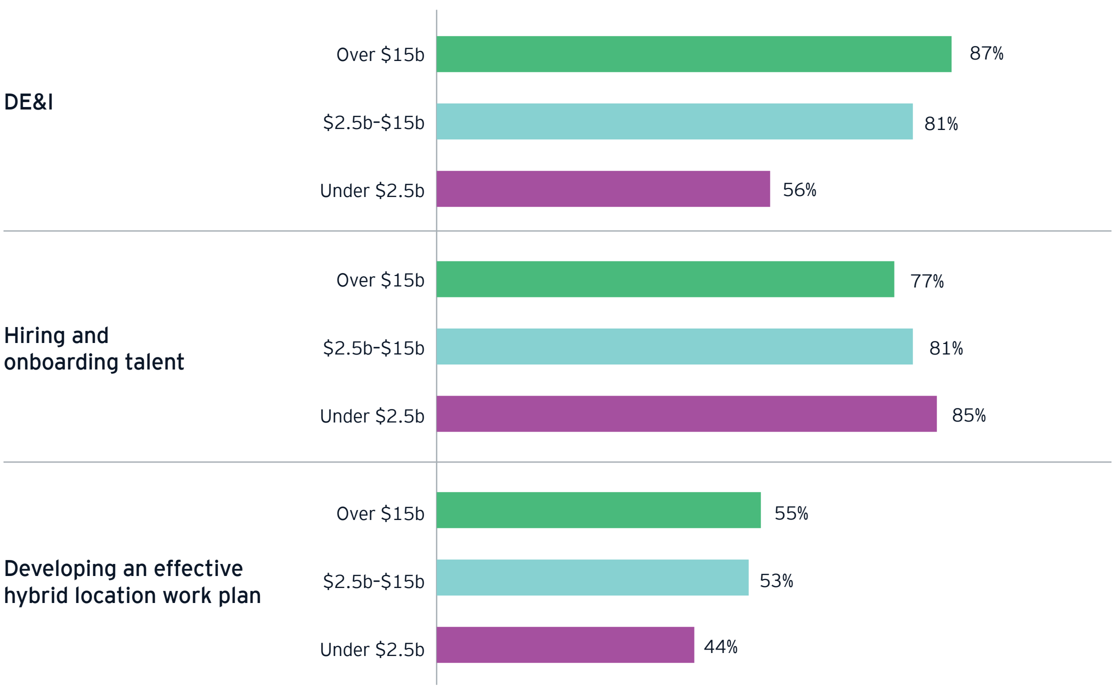
TALENT MANAGEMENT

As private equity firms continue to build more mature, sustainable operations, they have also focused on how they go about expanding their talent management programs. Improving diversity, equity and inclusion (DE&I) is a key to building a sustainable private equity brand that delivers greater value to investors.

Fund managers also ranked hiring and onboarding talent as an extremely important talent management priority. Even with all the technology investment over the past few years, private equity and venture capital continue to be people-first businesses. Amplifying the right talent with diversity of thought is seen as a talent management model that will deliver long-term value for firms.

In recognition of the impact the COVID-19 pandemic has had on the willingness of employees returning to their offices full time, which demonstrated that employees can be productive anywhere, 55% of the largest firms cited developing an effective hybrid office or work-from-home plan as a major priority, with 53% of midsized firms indicating it was also a talent management priority.

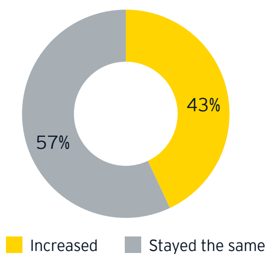
What are your firm's most important talent management priorities?



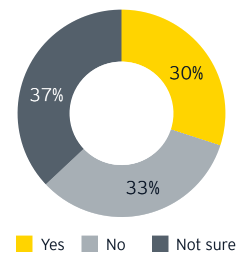
As firms have moved to develop more rigorous talent management policies, investors have reported that the quality of those policies matters. Limited partners are spending more time reviewing the effectiveness of their private equity firms' talent management programs. Some 43% said they have increased their scrutiny of talent management programs during due diligence, with 30% saying they were confident that a better talent management program signals their ability to retain and attract top talent. Investors are continuing to sharpen their focus on the talent programs of the firms they invest with and expect those firms to meet that challenge head on.

How do investors view talent management?

Over the past three years, how has your scrutiny of managers' talent management programs and policies changed?

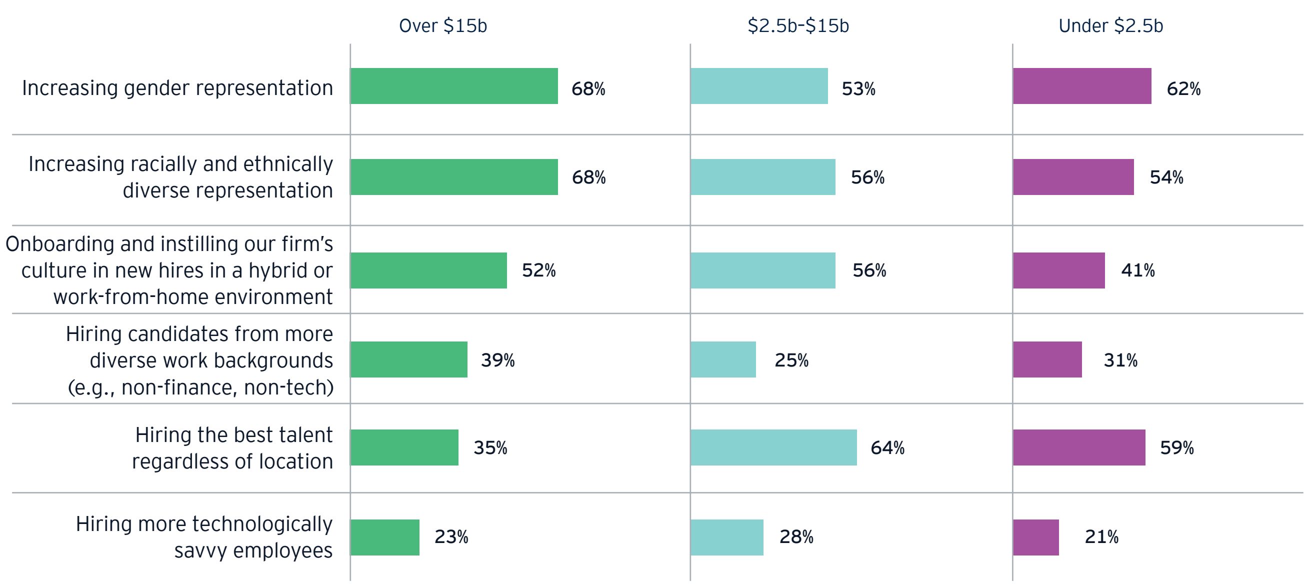


Does a more mature talent management program signal an ability to better attract and retain personnel?



Most talent management programs start with answers to questions regarding who are we recruiting, where are we recruiting them from and what is our "why" story. The larger firms have answered the questions quite clearly. They are looking to increase representation to diversify their talent base, and they have moved DE&I to the top of their talent management recruiting priorities. This is complemented by the recognition that with an expanded ability to work remotely, sourcing that talent nationwide, and even worldwide, is an option that is now on the table. These represent major changes in the traditional ways of sourcing talent for many private equity firms, but the long-term value associated with this new way of thinking could be monumental.

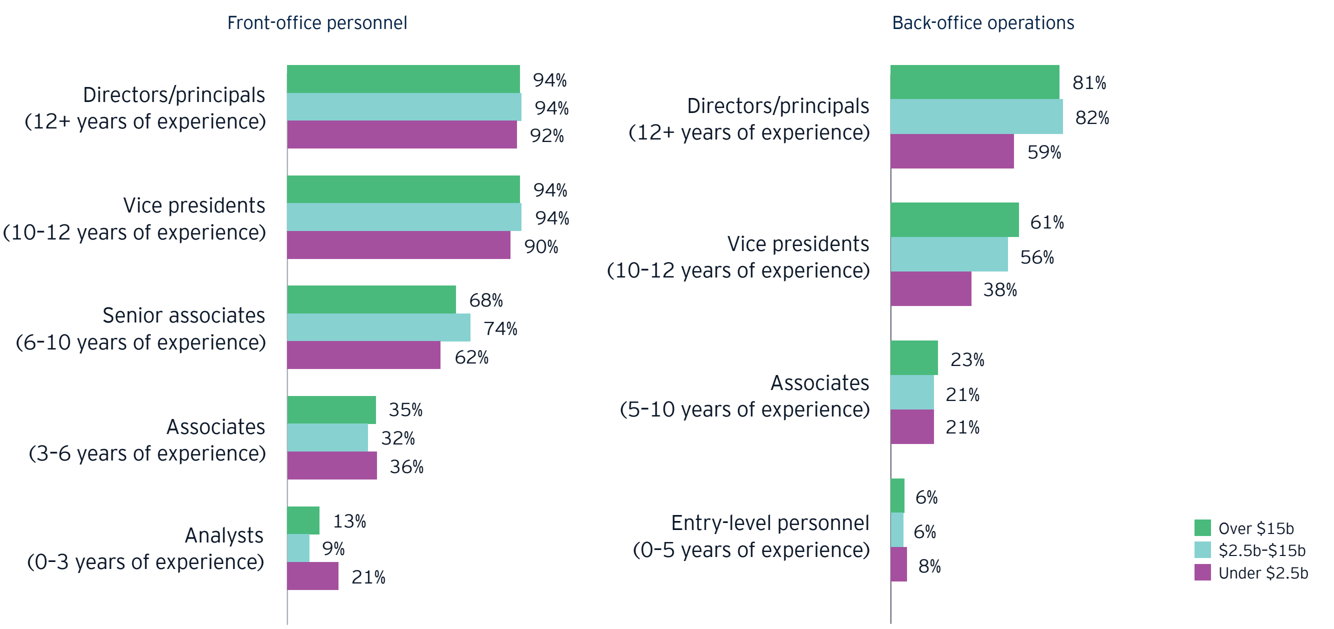
What are your top priorities in hiring and onboarding talent?



Retaining talent is still top of mind for many private equity firms. Firms are realizing that as they pour resources into recruiting and onboarding top, diverse talent, they also need to back that up with engagement and retention tools that further motivate employees.

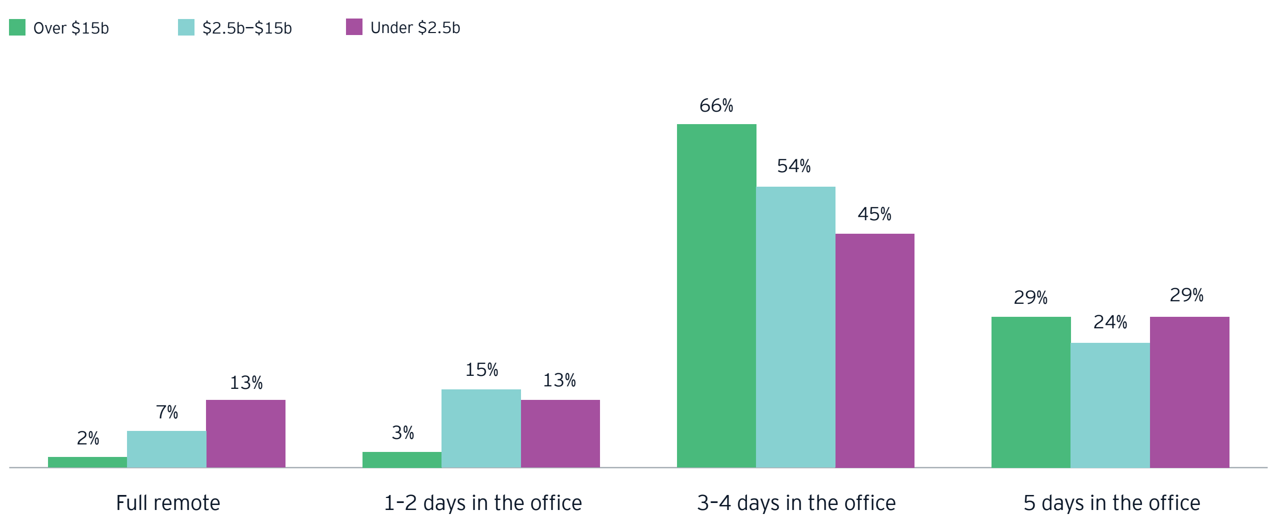
In that light, the top retention tool remains compensation. Private equity and venture capital firms have a unique lever to pull when it comes to compensation in the form of carried interest. Our survey found that most employees in the front office with over 10 years of experience tend to be paid some level of carried interest. At the larger firms, only CFOs have the luxury of retaining talent through compensation packages that include this option until those employees reach a senior level at the company. Trying to find the balance of retention of top talent through providing carried interest continues to be a challenge that compensation committees and owners need to keep top of mind.

To which of the following non-partner employees do you offer carried interest?



As we noted in last year's survey, the COVID-19 pandemic and the ensuing lockdowns prompted what could be a major paradigm shift in terms of working arrangements for nearly every private equity firm. Before COVID-19, very few firms even considered offering remote working as an option. That has changed dramatically. While vaccines and testing have mitigated some of the risks associated with a return to the office, most firms nevertheless indicate they are gradually returning to the office. As the COVID-19 pandemic begins its shift to an endemic, this topic will remain in the forefront as firms consider (and reconsider) when, how and whether they will be returning to the office. With employees becoming more comfortable with an operating model that includes working remotely, we may see a situation where talent demands that option going forward.

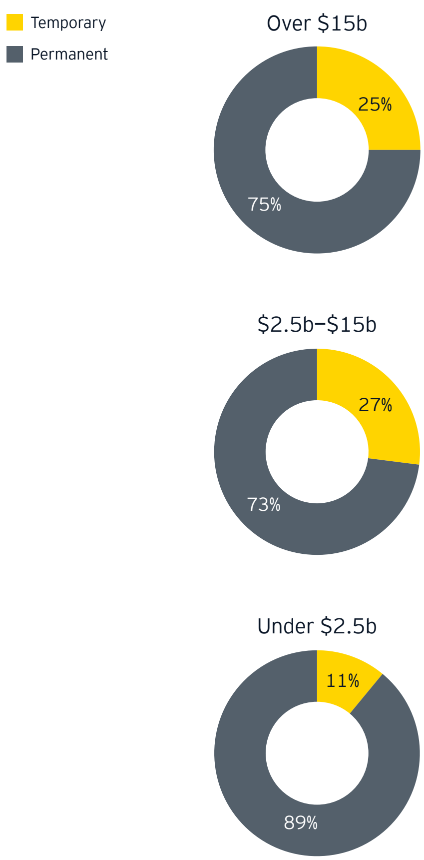
What is your firm's current return-to-work plan?



When surveyed about a potential paradigm shift related to the work location model, the vast majority of firms, regardless of size, expect that the hybrid work model will be a permanent arrangement going forward. This is a change of thinking since last year when the majority of firms felt their operating model would only be impacted moderately.

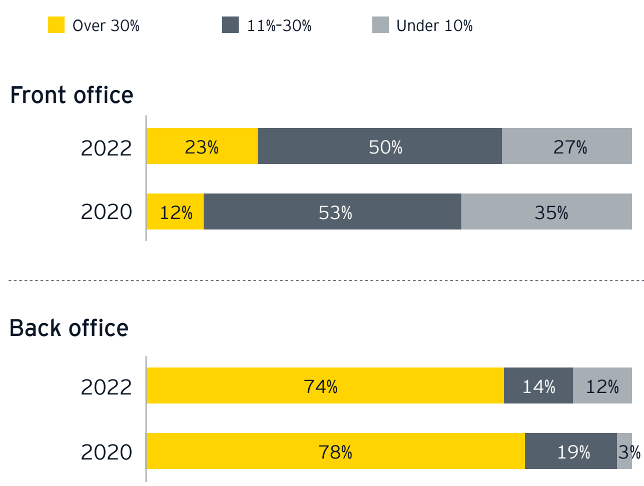
Will this shift in the following year? That's hard to say. In light of the reluctance of employees to return to working full time in an office, some firms may find that the need to retain employees leads to offering more flexibility for remote working arrangements.

If currently in a hybrid work model, will it be a temporary or permanent arrangement going forward?



Over the last several years, we have seen an increase in fund managers hiring women for positions in both the front and back office, and this year was no different. In the survey, the ratio of firms with more than 30% of women in the front office increased from 12% in 2020 to 23% only two years later. Nearly half of all firms reported that women accounted for 11% to 30% of their front-office workforce. In the back office, the ratio of women continued to far surpass their representation in the front office.

What proportion of the members of your firm are women?

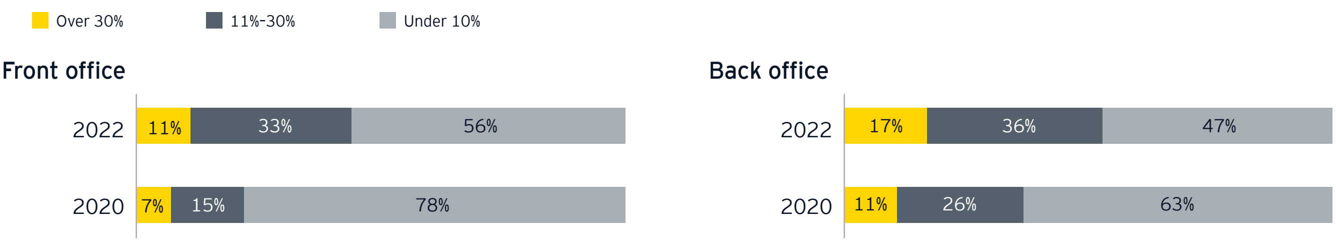


Fund managers also continued to focus on hiring more people with racially and ethnically diverse backgrounds in both the front and back office. Approximately one in five private equity fund managers increased the proportion of these groups in front-office positions to greater than 10%, and one in six private equity managers increased the proportion in back-office positions to greater than 10%. Among firms with more than $15 billion in assets, only 8% reported that people with racially and ethnically diverse backgrounds accounted for more than 30% of their front-office employees, while a further 29% of the largest firms said they accounted for 11% to 30%.

People with diverse backgrounds make up only a slightly higher percentage of the back-office workforce. However, there has been clear improvement on the DE&I front when it comes to adding people with ethnic and racially diverse backgrounds over the past year in both the front and back office.

While we have seen measurable progress made from our 2021 survey to the current survey with respect to gender and ethnic representation in the private equity industry, fund managers need to remain vigilant in their efforts to further increase the diversity of their front and back offices. Managers who don't take a proactive approach may soon find themselves considered industry laggards and have a significant proportion of investors begin to ask "Why?" and take their capital elsewhere.

What proportion of the members of your firm are underrepresented people with racially and ethnically diverse backgrounds?



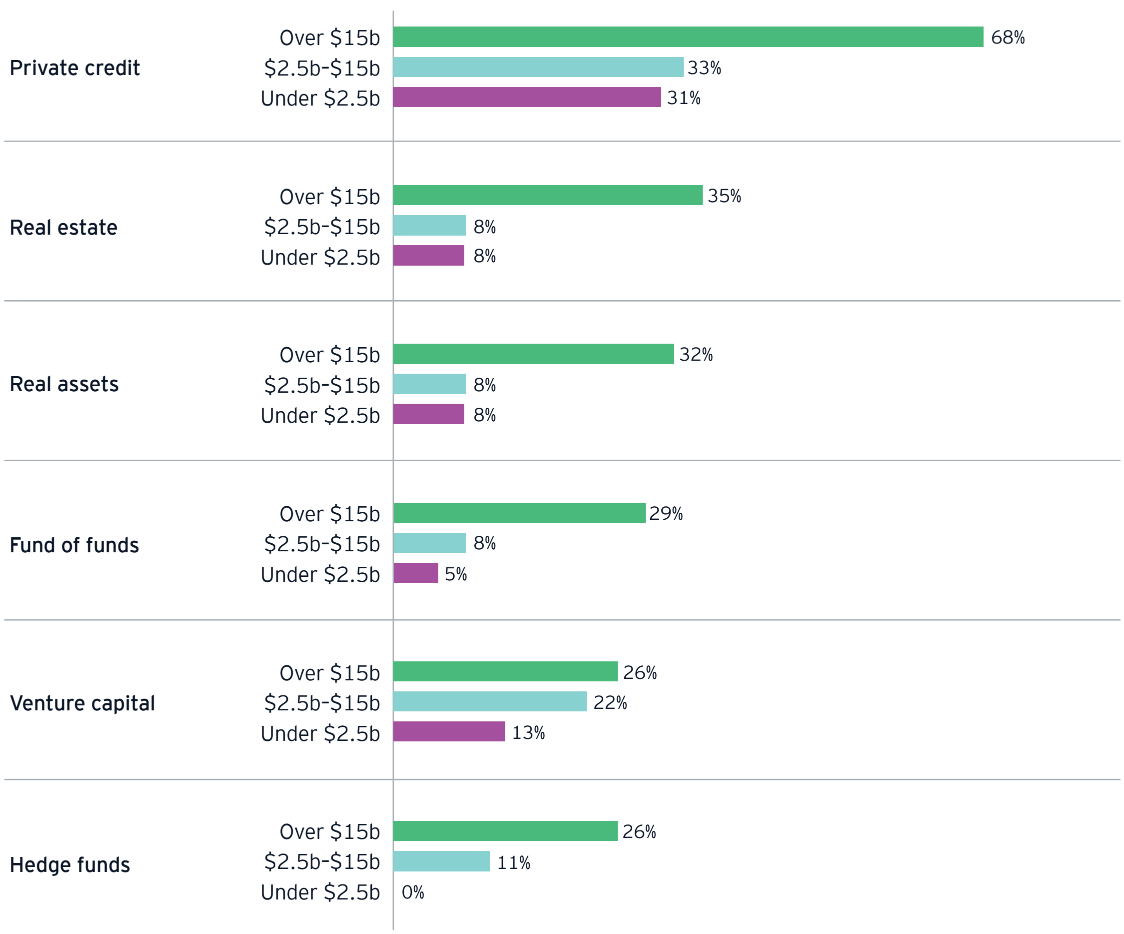
CHAPTER THREE

AN EXPANDING MENU FOR INVESTORS

A broad catalog of investment and funding options is often a key characteristic of financial firms that have taken a step forward on the maturation scale. To that end, as private equity and venture capital firms evolve, they continue to evaluate new product offerings as an option to attract investors.

Decisions made to launch new product offerings are not being taken lightly as the most mature firms are fully vetting each angle to make sure the new product aligns to their strategic vision and would create long-term value and not tarnish the firm's current brand equity. Firms are exploring new offerings areas, such as ESG funds and cryptocurrency, and prospecting new exit strategies, such as continuation funds and accessing the secondary markets.

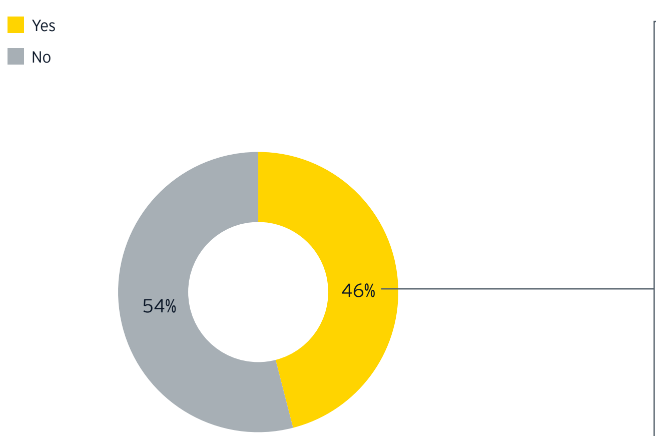
Aside from private equity, which products do you offer to clients?



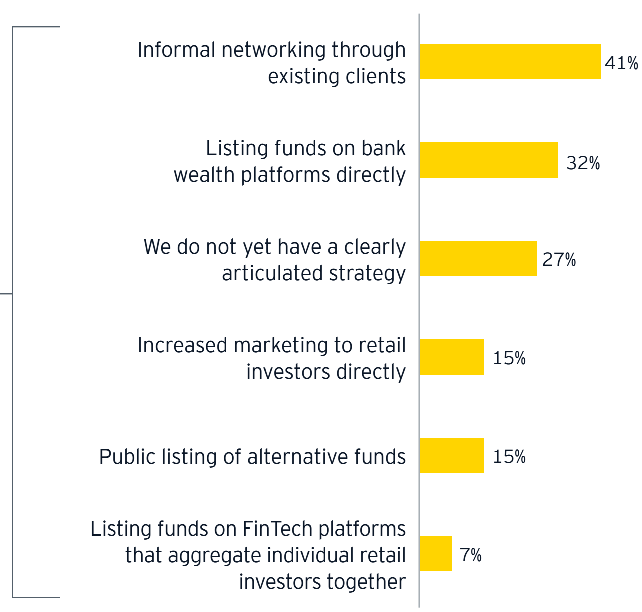
Moreover, while the amount of capital available to private equity firms right now is unprecedented, this hardly means firms are sitting on the sideline waiting for investors to come to them. For example, this year we've seen more than 40% of fund managers seek to raise funds through retail and wealth management channels.

To achieve this goal, firms have started listing funds on wealth management and retail investment networks. Firms will continue to monitor investor regulations to see whether they are able to broaden the investor base that can access the private markets.

Are you seeking to increase the amount of capital from wealth and retail channels?



Which of the following strategies are you considering to increase capital from wealth and retail channels?



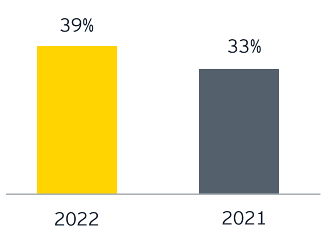
As we saw in 2021's survey, investors are increasingly interested in sustainable investing options, with 39% saying they invest in ESG-related products. This is up slightly from 2021. Investors primarily invested in socially responsible funds, followed closely by those that addressed specific environmental and social issues.

In 2021's survey we discussed the emergence of ESG as a competitive differentiator. While ESG continues to be a focus for some firms, our 2022 survey indicates that the majority of fund managers still have yet to develop an ESG offering as they wait for greater clarity on how to measure its effectiveness as an investment vehicle.

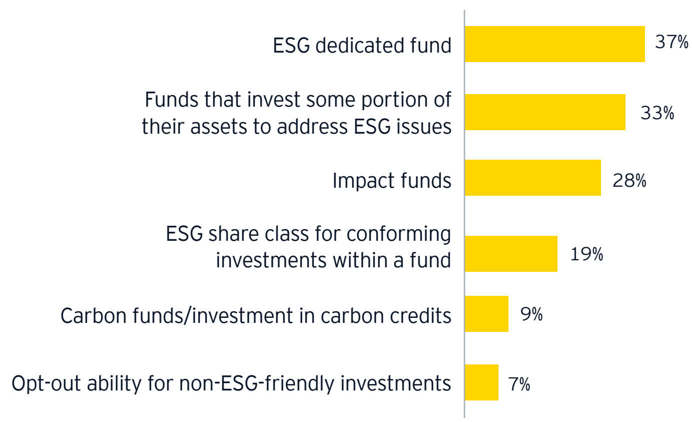
As described last year, the trend continues where North American private equity firms clearly trail their counterparts in Europe and Asia. However, our 2022 survey also indicates ESG product offerings have risen over the past three years, regardless of firm size. Firms should strategically address how they will respond to ESG requests and questions by investors. Although the sustainability narrative does not need to be the same among firms, investors are looking for their managers to tell "their story" and how they are being responsive to requests from their investor base regarding ESG principles.

How do investors see ESG investing?

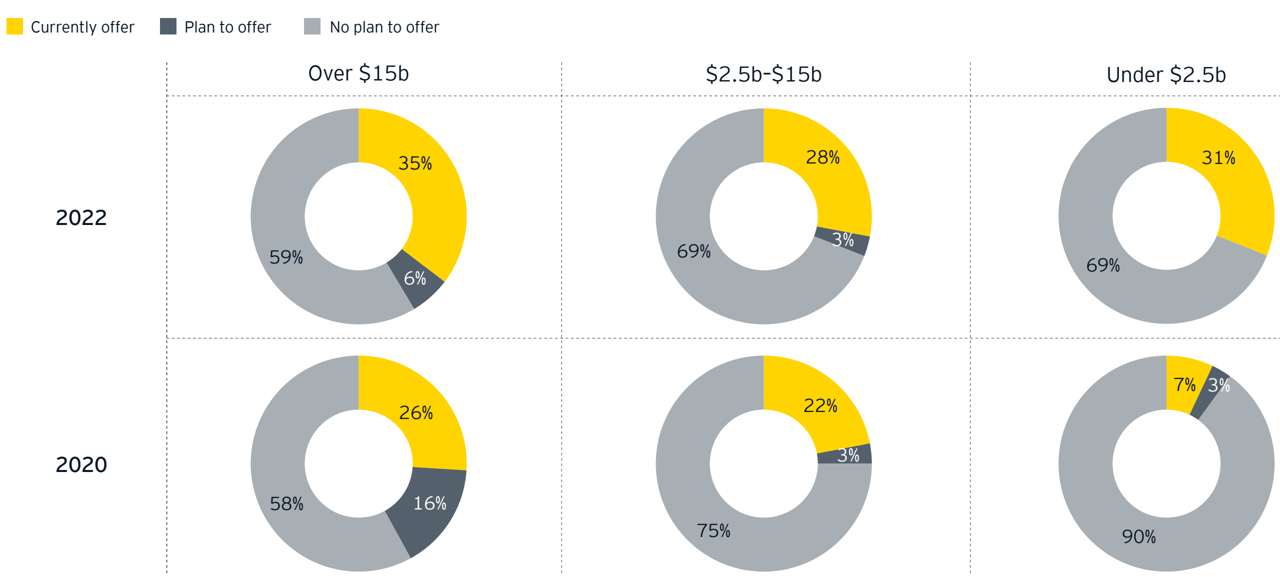
Do you invest in ESG product offerings?



In which ESG structures do you plan to invest?



What percentage of managers are offering ESG products to investors?*



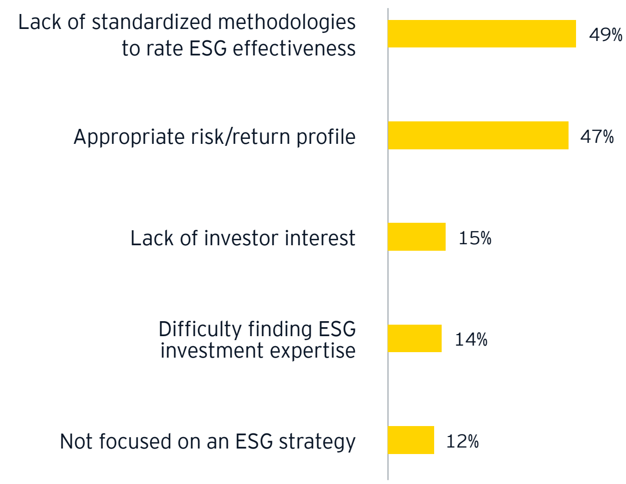
*Question not asked in 2021

Despite the clear benefits of adopting ESG practices, managers weighed in on some of the obstacles that have them reluctant to offer products in that space. As broadly noted in various media reports, there is currently no consensus on a global framework for ESG. Currently, many managers are following the guidelines of their choice or creating their own internal models to determine what would make an investment, or fund, ESG compliant. Along those lines, determining and/or scoring the effectiveness of an investment can be challenging.

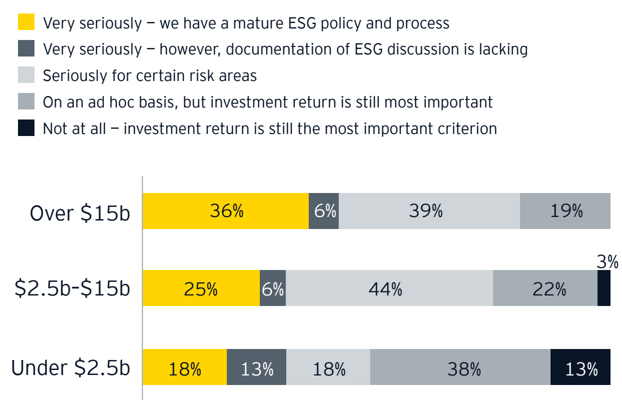
Many managers have turned to creating custom scorecards to rate just how effective their portfolios are with respect to ESG. With no global framework for sustainability investing, some managers have opted not to market funds as ESG compliant as some may not view compliance the same way. Even more interesting, some managers say they are hesitant to launch ESG funds as they feel they may not provide the appropriate risk or return profiles that they believe investors are demanding.

Overall, 42% of the largest fund managers say they consider ESG issues either seriously or very seriously in their decision-making process, while a further 39% say they consider these issues seriously in certain risk areas. Smaller managers report a reduced focus on ESG risks and opportunities in their decision-making process. Investors are looking for managers to invest in line with their ESG policies and procedures, while also returning capital that outperforms certain benchmarks. Investors no longer see investments based on sustainability as a trade-off. In other words, they are no longer willing to accept weaker performance related to more ethical investment decisions as they will increasingly seek to build well-performing, socially responsible portfolios. Strategically thinking through decisions about ESG will continue to be extremely important in order to secure the investors of the future.

What obstacles are you encountering in launching ESG funds?



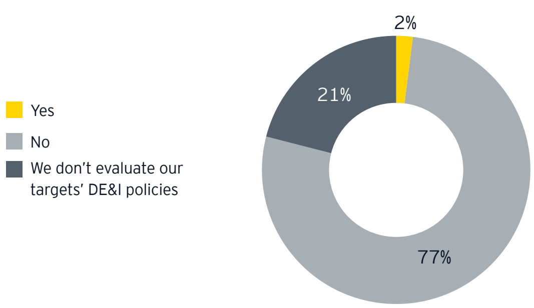
How seriously are ESG risks and opportunities contemplated in the investment decision-making process?



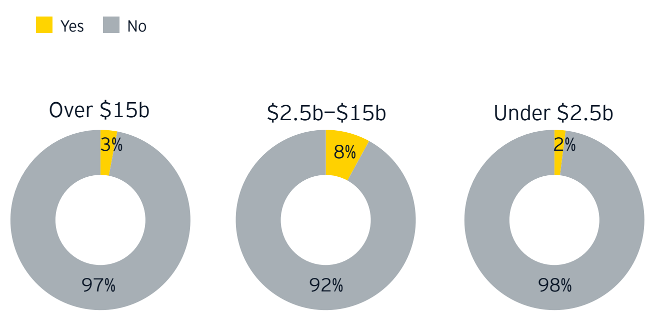
DE&I is one area of ESG currently getting a lot of media focus. Surprisingly, given the focus that firms have on ESG, only 2% of managers surveyed responded that they've turned down an investment opportunity because of a portfolio company's DE&I policy. As firms expand their ESG footprint, we recommend that managers build out a formal investment review that has "deal-breaker" potential if portfolio companies do meet certain guidelines. If those portfolio companies do not yet have DE&I policies, private equity and venture capital firms have an opportunity to assist their companies in creating a policy that would align with their own DE&I policies.

In another area that has ESG implications, firms have also taken a cautious approach with cryptocurrencies. Only 3% of the largest firms have invested in crypto-related or digital assets. We believe that cryptocurrency and digital assets will continue to be an area that many private equity and venture capital firms will consider going forward. The survey results also show that most firms are exercising caution here as they continue to watch how governments and regulators treat cryptocurrency and determine how it fits into their strategic vision of the suite of alternative investment options for investors in the future.

Have you turned down an investment opportunity because of a target's failure to address DE&I to your firm's standards?



Are you investing in cryptocurrency or digital assets?



BACKGROUND AND METHODOLOGY

The purpose of this study is to record the views and opinions of CFOs, COOs and heads of finance at private equity and venture capital firms around the globe.

Topics include the evolving importance the management company function is playing in directing future strategies of the firms as their operations evolve talent management and fund product offerings.

From May to October 2021, Greenwich Associates conducted telephone and online interviews with managers from 107 private equity and venture capital firms. In addition, we also interviewed 54 institutional investors.

All amounts in the survey are US dollars unless otherwise stated.

For several of the questions, multiple answers were allowed resulting in responses that do not total 100%.

Respondent profile

What are your firm's total assets under management?

Over $15b	$2.5b–$15b	Under $2.5b
31%	35%	34%

Number of firms surveyed

This survey brings forward the perspective of 107 private equity firms of a wide range of sizes and complexities that have operations around the globe.

107
FIRMS SURVEYED GLOBALLY

54
NUMBER OF INVESTORS SURVEYED

CLOSING

Private equity firms have made significant strides over the past decade and now play a key role in the financial ecosystem as a source for working capital, helping investors fund new technology, acquire new companies or bolster the balance sheet of existing organizations. In our survey, we've watched as firms have evolved into larger, more complex organizations that are now responsible for trillions of dollars of investments in a wide range of companies and organizations.

As we look to the future, we believe it's time for fund managers to further their initiatives to advance DE&I in their own ranks as well as within their portfolio companies. At the same time, they can make a positive contribution to the ongoing debate on ESG issues through expanded offerings in their portfolios as well as by influencing board decisions.

These efforts should not come at the cost of asset growth. Indeed, we view these steps as instrumental to building a sustainable future for the industry as well as the broader world of business. Private equity firms should take pride in how far they have come and also recognize that the best part of their journey lies before them.

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