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Outsourcing is on the rise as management companies face greater scrutiny and higher costs

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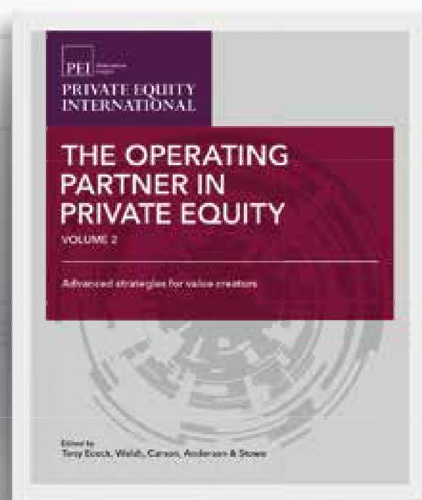

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Private Funds CFO

Management Company Report

ISSN 1474-8800 • JUNE 2022

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Insight

Three key misconceptions

Certain beliefs about management company administration may have been true in the past, but no longer are the case

Common wisdom – by its intrinsic ubiquity – can be rather convincing. But common wisdom will not stay wise if it ignores new evidence that disproves the assumption. GPs appreciate this, given how often they stress test the assumptions made in an investment case. Indeed, that institutional skepticism is often a point of pride for fund managers who are busy building proprietary dealflow by questioning that which "common wisdom" has rejected, ***writes Rob Kotecki***.

But there are only so many hours in the day, and today's GPs are already trying to cram a 25th hour into their schedules. With so little excess capacity, the (seemingly rudimentary) administration of the management company plows along unexamined. This can leave managers assuming it can be easily handled by the in-house finance staff; that if they outsource that administration, the service provider is there to provide an extra pair of hands and nothing else; and that there's no cost in delaying upgrades. But these three assumptions are largely incorrect.

What complicates matters is that these misconceptions have some semblance of truth. The in-house staff can indeed handle it – many have done so for decades. Service providers do offer manpower. And the saving made for delaying an upgrade may be worth it, if there simply isn't the budget to tap a third party or some sophisticated platform – especially for those managing a debut fund, when the firm might be held together with shoestring and one wheezing printer for pitch books.

But these assumptions do obscure the reality of administering the management company today. In-house staff can get overwhelmed as the firm's AUM swells. Saving money on the management company at the launch of a firm can eventually cost plenty in time and money when it's time for an upgrade. And today's service providers aren't just offering a pair of hands, but expertise, given that GPs often don't have the spare time to master the nuances of the management company themselves. Here are three common misconceptions:

1 In-house staff will be sufficient in the long run

The firm can tackle the management company administration in-house when it's a matter of a couple of funds, with a small staff. But even at the launch there's a lot to be done. The problem is that it can be hard to discern when the size or complexity of a fund begins to tax the internal staff, until it's already *overtaxing* them. They may be working through the weekends to prep that quarterly report. They might miss a filing deadline, which may not be a serious error, but it's indicative of a sloppiness that might produce more grievous mistakes. They might misallocate fees or expenses, which the Securities and Exchange Commission doesn't look too kindly on these days.

And this burden courts other downstream consequences, as the internal finance team neglects other duties to keep up with management company demands. The trickiest part of this is that these crunch times might not be constant, but it's important to pay attention when they arrive. Hiring more people might not make sense either, as there isn't always a steady volume of work to warrant another person to manage.

Then there's the matter of in-house tech, which at the launch of a fund could be an updated version of QuickBooks. That might do the trick to start, but that consumer grade software likely won't be compatible with what a fund administrator is using. And a firm that's using QuickBooks for the management company will likely be outsourcing their fund administration, precisely because they don't have the resources to do that internally.

That incompatibility requires many more manual processes when exchanging data between the funds and the management company, which slow things down and risks more human error. There's no easy flow of data between the funds and management company, and that doesn't get any easier with additional volume or new asset classes.

2 Outsourcing only solves the labor problem

As much as this makes the case for outsourcing the management company administration, it's not quite that simple. Yes, the internal staff will be freed up to focus on higher level work, and someone else will be left to sweat maintaining and upgrading the technology in play. But GPs should expect service providers to offer far more than an extra pair of hands. A service provider for the management company should be a collaborator, advising on best practices they've cultivated over years with other clients, and helping clients to plan their future, and not just service the present.

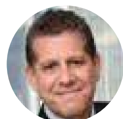
The best service providers are thinking two or three steps ahead and working with the internal staff on any tax or regulatory change on the way. The GP shouldn't be aiming to merely get the work off their desk but finding the best way to manage these tasks. It's true that a lot of management company work is straightforward, but in the event of a question, GPs should be able to trust that their vendor will offer an informed answer. After all, how else will they avoid the kind of "common wisdom" that's already out of date?

3 There's no cost to delaying institutional grade servicing for the management company

All that QuickBooks data adds up over time. It might not seem too much of a burden, until of course, there's an audit, which often will review the firm's activity all the way back to day one. Suddenly, the team's frugal approach doesn't seem like such a bargain. A recurring theme among private equity CFOs we spoke with on the matter was the value in starting out with the best processes, protocols and systems possible, because it will always be a pain to upgrade later, specifically due to training staff and executing a massive data migration project. Service providers will be happy to take on that onboarding, but they won't do such a thing for free.

For more mature firms, they might have invested in a powerful tech system early, only to discover that it was expensive or difficult to upgrade. Switching systems still requires a laborious onboarding process, not to mention additional training for staff, which even if it means less work in the long term, will be one more thing they have to find time to do. And as with the question of in-house staffing, it's hard to predict when that tech solution will be overwhelmed by the task at hand. These issues drove the popularity of outsourcing fund administration, and it looks to be doing the same at the management company level. ■

The Gen II view **As management companies face more scrutiny, cost data provides a valuable set of benchmarks**



Expert analysis by **Jeff Gendel**, principal, Gen II Fund Services

Internal expense ratios at private equity firms show surprisingly wide variability. That's why benchmarking expense categories provides useful information about peers' average spend on back- and middle-office capabilities, information that can raise important strategic questions as management companies increasingly face heightened scrutiny to drive efficiencies and comply with new regulations, all while scaling their business. Gen II's survey of management companies' core expenses categories, which captures expense percentages across a range of firm sizes, provides a fresh view into how firms prioritize their spending.

While no two private equity firms are exactly alike, they all share a set of common costs to operate their business, including compensation, technology and professional fees. Given the range of expenses among the various firm categories, it's clear why management companies are under the microscope. It's important for a firm to understand where they sit on the trend line to make the case either for increased investment in certain areas or to get a sense of where they may be overspending and committing precious resources that could be better served in other areas.

To be sure, many private equity managers tend to view anything outside of sourcing new deals, driving portfolio company growth, and realizing investments as a distraction to their day-to-day priorities. But against an increasingly competitive backdrop to raise new funds, limited partners are indeed scrutinizing back-office capabilities. And ILPA's updated version of its standard DDQ delves into everything from management company economics to cybersecurity, compliance protocols and whether or not firms utilize an independent fund administrator.

Returns still matter, but all else

> "The scope of management company challenges continues to grow more complex, particularly around regulation"

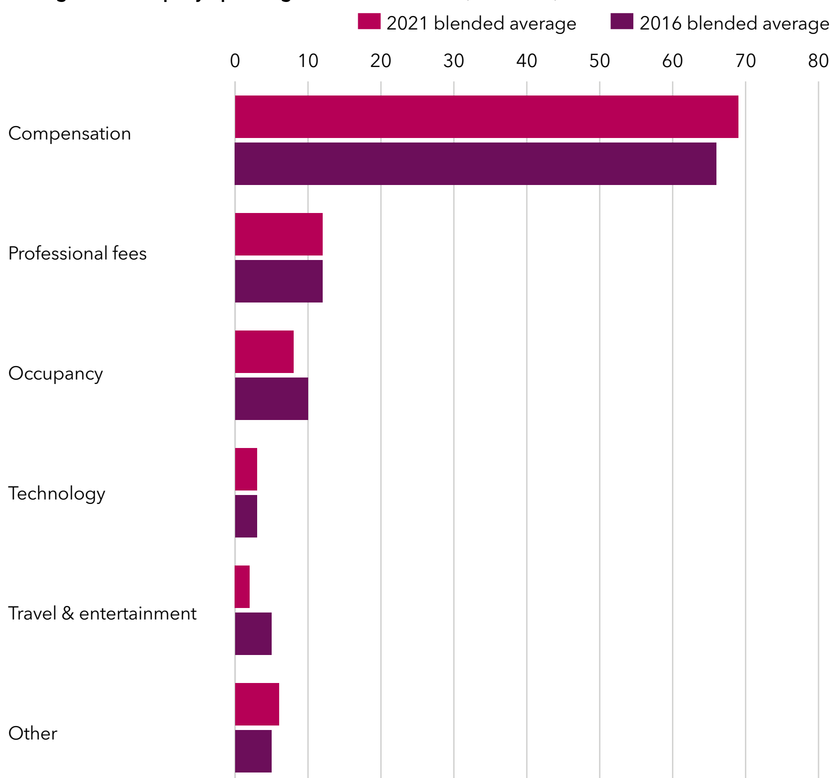
CATEGORIES

A wide divergence in expense allocations

Gen II's management company data captures expense percentages for six categories (compensation, professional fees, occupancy, technology, travel and entertainment, and other) across three size categories based on AUM. The high and low datapoints often reveal a wide divergence in expense allocations, underscoring that there is no set template for firm management spending.

being equal, the extent to which firms invest in their management company operations can make the difference between securing a commitment or walking away empty-handed.

The good news, according to EY's latest *Global Private Equity Survey*, is that a majority of private equity firms believe their management company was ahead of its peers in terms of "institutional maturity" (including 84 percent for the largest fund managers versus 56 percent among respondents at smaller firms). As might be expected, a minority of managers believe their management company could be considered best in class (19 percent for the largest fund managers, 14 percent of respondents at midsize and just 11 percent for smaller firms.) The same survey seemed to indicate that midsize firms see the correlation between AUM and back- and middle-office capabilities, as 39 percent of fund managers with between $2.5 billion and $15 billion



Source: Gen II Fund Services

Compensation

Compensation naturally dominates expenses across the three AUM groups. The blended average for the compensation percentage moved up to 69 percent, from 66 percent when Gen II last surveyed management companies in 2016. The smaller firms (AUM between $50 million and $500 million) had the lowest compensation percentage at 63 percent of costs, reflecting the larger impact of overhead. Compensation at both midsize ($500 million to $1 billion AUM) and large ($1 billion-plus AUM) firms averaged 72 percent. In the $1 billion-plus category, average compensation as a percentage of costs grew by 7.5 percent over the five-year period. In terms of outliers, compensation percentages were as high as 96 percent of total costs and as low as 26 percent in the smallest AUM category, but also as high as 87 percent and as low as 44 percent in the $1 billion-plus group.

Professional services

Legal, accounting, consulting and other services are perhaps the most fungible expense item from year to year, particularly when looking across the different AUM levels. For instance, in the smallest category, firms with assets of between $50 million to $499 million, the average grew to 18 percent of their total operating expenses last year (versus 14 percent in 2016). The median, however, shrunk over the same period of time by 200 basis points to 11 percent, suggesting that some outliers are committing significantly more of their budget in this area than others. Meanwhile, the data also underscores that larger firms enjoy economies of scale in this area, and on average, allocate just 9 percent to professional fees annually, down from 13 percent five years ago. The blended average (12 percent) remained consistent with the 2016 benchmark.

> "The extent to which firms invest in their management company operations can make the difference between securing a commitment or walking away empty- handed"

of total assets under management cited enhancements in these areas a top strategic priority.

New pressures mount

The scope of management company challenges continues to grow more complex, particularly around regulation. As private equity grows in scale, the SEC has ramped up its scrutiny of management companies. Earlier this year, the commission unveiled a wide-ranging proposal to overhaul private fund reporting requirements. Making sure management company books and records are in order and easily reportable and auditable has become a higher priority.

Moreover, there's been a rapid increase in the number of GP stake sales, in which private equity firms sell minority positions in their management companies to third-party investors. This trend is helping to institutionalize the back and middle office, and some investors in this area, such as Goldman Sachs-affiliated Petershill Partners, even differentiate themselves through GP services to aid in everything from human capital and ESG engagement to operations consulting. The presence of a third-party owner can complicate audits, compelling the management company to provide a more robust set of reports to meet the requirements of their new minority owner. And that has put a lot of stress on management company teams who have not reported on those metrics before and are now forced to on a going-forward basis.

Looking ahead, human capital and the value of retention has become a key priority as private equity firms increasingly recognize the costs of losing talent. This is no small consideration for the back-office roles at management companies, given the nuances and evolution of reporting requirements and the constantly moving target of new regulations. Highly experienced talent is more valuable than ever, as there's no question that private equity fund structures become more complex with each passing year. ■

CATEGORIES

Continued from page 5

Occupancy; Travel and entertainment

Average occupancy as a percentage of costs dropped by two percentage points from 2016, in part reflecting the office space reset in the covid era. The blended average for 2021 was 8 percent, with slightly a slightly higher percentage for smaller firms (9 percent) and lower for midsize firms (6 percent). The covid effect also played a significant role in lowering the average blended T&E costs to 2 percent in 2021, down from 5 percent in 2016.

Technology

Surprisingly, technology and IT costs remained static over the past five years, and across all size levels, the blended average accounted for 3 percent of total operating expenses. This may speak to the relative consistency of SaaS subscription models. At the same time, however, it stands in contrast to the growing emphasis on data and speed documented in the aforementioned EY survey.

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Private Funds CFO
Published 6 times a year by PEI Media. To find out more about PEI Media visit **thisisPEI.com**

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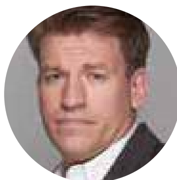
Editor's letter

Managing for the future



Rob Kotecki
rob.k@peimedia.com

It's only natural to feel nostalgic for the good old days, back at the dawn of the private funds industry when a few brave souls raised some cash, bought some businesses, cut some costs, hired a new CEO, maybe even reformed a supply chain, and then sold for a tidy profit, with a back office that consisted of one accountant and some administrative assistants.

Of course, it was never that quaint, and none of those finance "cowboys" would trade away the growth and influence of the asset class today, just to skip the trouble of more institutionalized practices. After all, a lot of those cowboys ended up trading away their horses and hats to lead some of the biggest "ranches" out there. Still, as the industry matured, LPs and regulators both got more sophisticated in their understanding of the space. And that meant an ever-shrinking margin of error, even for a firm's operational staff.

> **"Administration of the management company seems to have grown in volume and complexity"**

As a result, fund administration evolved into its own discipline, and service providers arrived, eager to take these tasks off their clients' desks. And now even administration of the management company seems to have grown in volume and complexity.

That's why we're examining how GPs think about their management company (p. 4) and why they should consider outsourcing (p. 10). We spoke with GPs about their experience outsourcing the management company from the very start (p. 15) and what that outsourcing relationship looks like a decade later (p. 20). And we asked a service provider for their advice in selecting the right vendor (p. 8), and about the value in having a single vendor serve both the funds and the management company (p. 16).

What we found is that outsourcing is booming for a reason: it works.

Rob Kotecki

KEYNOTE INTERVIEW

Savvy sourcing

Finding the right service provider to assist with management company administration is one of the most important decisions a GP can make, says Michael Pollack of Gen II Fund Services

Fund managers looking to outsource their management company administration are aware of the volume and complexity of work, and certainly the risks of a missed deadline or an incorrect regulatory filing. Selecting the right administrator to partner with is a critical decision that should be carefully thought through to ensure the product and service offerings match the needs of a GP. Michael Pollack, head of client delivery and innovation at Gen II Fund Services, offers his insights to help GPs discern the best ways to decide on a service provider for their management company.

Q Once a firm has decided to outsource its management company administration, how should they go about sourcing a service provider?

The next step is to consider the complexities of that management company. Each firm should identify their needs from the functionality, service and connectivity perspectives. There are standard issue tasks, such as quarterly and annual reporting and filing, but it's important to remember the management company is deeply interconnected with the firm's fund administration. And this means that the firm's complexity, in geography, asset classes, investors and volume do impact the management company. We've found that it is mutually beneficial for us and our clients when we provide service to both the fund level and management company entities.

Q How important is the service providers' geographical location? With the rise of outsourcing to India, do they even need to be in the same country?

We believe that where we're located matters. Fund managers should ask who is doing the work, and where. We don't outsource to India or any other country. Offshoring can sometimes offer some price compression, but what's gained there is often lost in the quality of service.

Additionally, having a provider in a distant time zone can limit the opportunities for collaboration, which is where we feel we add a lot of value. All of our work is done by employees in the US, with offices across the country

allowing Gen II to effectively service every US time zone.

Q Outsourcing always brings up questions of control. How much should GPs expect to control the process when they engage a third party to tackle the administration?

Control is key, especially if a firm has historically handled the books for the management company themselves. They don't want to lose access to data. And they shouldn't. We offer self-service dashboards that grant access 24 hours a day, seven days a week. That's not to say they don't have access to staff to answer a question, but that's in addition to being able to view or download what they need, anytime they need it. And any service provider should offer that.

Outsourcing should never make the GP feel like they've been locked out from their data. But I'd also like to add that it's not enough to merely grant "access" to that data, where clients are left to download massive information extracts that leave them hunting for what they need. "Access" should mean access to information that is necessary in a usable form that can be obtained with ease.

Q How should a GP evaluate the service provider's expertise?

They'll certainly want to know the qualifications of the team, in terms of skillsets and the number of years in the industry, but also gain an understanding of the types of clients they already service. We've worked with so many clients of different sizes, strategies and vintages, that we can help that emerging manager predict their needs and meet them in the coming years. Or it's a veteran firm that never faced a given situation before, but we've already managed something similar on behalf of another client and can step in with a solution. It's not just about expertise; it's about experience as well. Part of the value of outsourcing is being able to leverage collective intelligence, built over years of service. And that also means selecting a service provider that can service the firm no matter how large or complex it gets over time.

Q GPs often prize continuity in a service provider's team, but how can they discern if the team serving them is built to last?

There's no doubt that continuity is important. The longer a particular individual works on a given account, the more comfortable the client is, and a shorthand is cultivated which makes everything run smoother. And the best way to vet that is by asking the potential service provider what they're doing to drive retention. How do they cultivate a positive culture that keeps employees engaged? We are very open about our efforts on this front.

"Retention rates at the more senior levels are critical as those are the individuals that have the most direct client interaction and ensure all deliverables are planned and executed properly"

This includes several initiatives, from a client service bootcamp, to continuous training, to our market comp studies that ensure we're paying our staff in a way that is commensurate with the market, their experience and their skillset. Our belief is that we should never lose people to another administrator. It's the same client base, the same kind of work, and if we're losing people, it's a failure of management and culture. That's why we make it such a priority, with real focus and investment.

A potential client can hear all about these programs and intentions, but how can they gauge if a provider has a culture that will foster continuity? The truth is that there will always be some turnover among first- and second-year associates as they better define their career objectives. Retention rates at the more senior levels are critical as those are the individuals that have the most direct client interaction and ensure all deliverables are planned and executed properly. The best indicator of future continuity is the retention rates of mid-level and senior personnel.

Attracting, developing and retaining talented individuals is at the top of our priority list. It can be difficult for accountants to grow their careers at GPs, where they can sometimes be viewed as overhead and lack visibility within the organization. We believe we can offer accountants a robust career path where they can continue to learn and grow, experiencing a variety of clients, products and structure without a career ceiling. The ability for continuous learning and growth provides a win-win situation for us, our employees and our clients.

Q What's the most important factor in choosing a service provider?

I said before, but I'll say it again. They have to select a partner that can grow with them, and tackle not just who they are today, but who they aspire to be, five, 10 or even 15 years from now. ■

Great housekeeping

GPs often underestimate the effort and expertise required to service their management companies, but with the right resources, they can stay in the good graces of regulators and focus on delivering returns, writes Rob Kotecki

Management companies for private funds are like a water heater or furnace, a necessity that requires care and maintenance, but doesn't command attention until they stop working. Like so much of the industry, administering management companies used to be simpler, but with the growth of regulatory attention, LP demands, assets under management and strategic complexity, the task isn't so easy anymore.

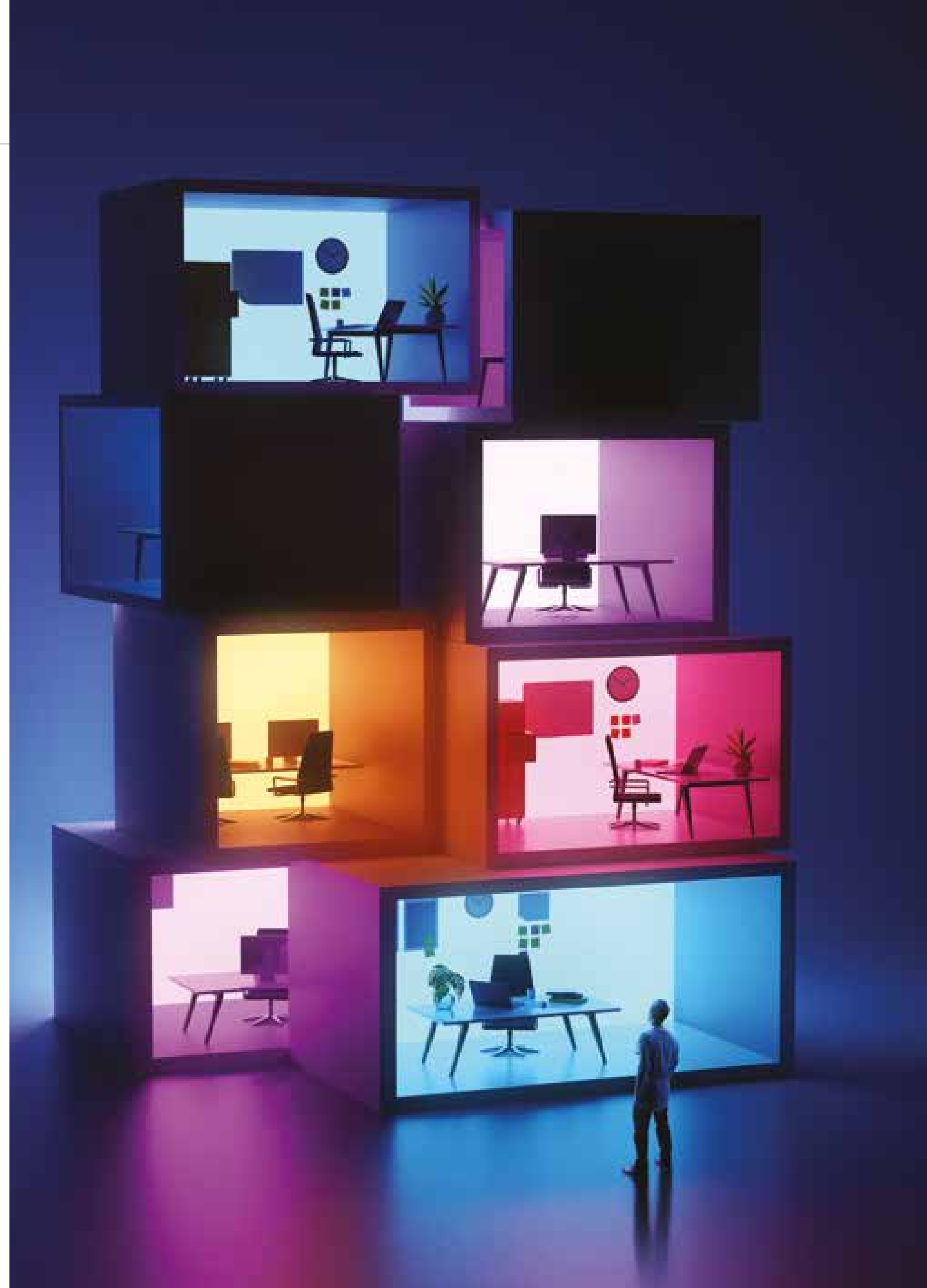
Which is why GPs should be aware of how much time, staff and expertise is required to service management companies today. The stakes are high, with regulatory sensitivity around fees and expenses, and investors eager for reassurance that a firm's back office is above reproach. Debut funds may be tempted to wing it until they grow in size but waiting comes with a cost. And more mature funds should make sure their tech and processes are up to the task, not just now, but for the size and complexity of the firm's long-term ambitions.

Fund managers have long understood the burden of fund administration and have been outsourcing to service providers, while keeping the management company books in-house. Most firms prefer to operate this lean, especially for their first few funds, and it might seem unreasonable to tap a service provider for the management company as well.

But there are risks in underestimating the burden here. Without the right infrastructure for the management company, it can court mistakes. If that regulatory filing is submitted late or incorrectly, it doesn't just risk regulatory action, but a reputational hit that investors won't appreciate. Especially for new firms that haven't built trust with LPs over multiple funds.

Attention matters

"The focus on accurate and supportable expense allocation is higher today than ever before," says Luis Gutierrez, a managing director with Gen II Fund Services. "That means that audits need to show everything is properly allocated. There can be tax issues as well, as an underserviced management company



might not be reporting income and expenses properly."

And there are also the unexpected tax and regulatory changes that an in-house staff might struggle to stay current with, such as when the IRS recently made sweeping reforms to how meals and other entertainment expenses are handled. Knowing about such changes is one thing. Fully understanding how they apply is another.

Gutierrez has seen instances when LPs have demanded a fund manager bring in a service provider to handle the management company, precisely to prevent these kinds of tax and regulatory problems. Management company administration might not be top of mind for investors, but that doesn't mean it's not an issue of interest.

"LPs want institutional grade services," says Michael Pollack, head of client delivery and innovation at Gen II Fund Services. "And as they grow more sophisticated, they're more sensitive to data security issues, and the reliability of the accounting package and talent. They want real transparency into all the numbers and appreciate the neutrality that service providers can offer in their work." LPs don't want any surprises from that SEC audit, even if they don't spell out their expectations around management company services.

That silence may encourage GPs to assume they can tackle the management company with the resources available. "We service clients of all sizes and strategies, and they all know how to fundraise, source deals, manage investments and even hire counsel, tax services and fund administrators," says Pollack. "But they can underestimate the critical nature and time commitment required associated with the management company, until they realize that all the duties add up over time into a great deal of work."

Pollack argues that the work requires a lot more staff and expertise than expected, including house-level expenses, invoice processing, bank reconciliations, travel and expenses processes; essentially all the books and records for the house-level functions. Some GPs have been known to resort to cheap solutions, believing they will upgrade down the line, but such shortcuts can be costly over time.

Staffing up

"Every client we have has aspirations for growth," says Pollack. "And that means their management company has to be designed for the long-term." But what some emerging managers might not appreciate is how big a staff can be required even during the first few years.

Pollack suggests an in-house team may need to be three to four people if GPs do it alone. "If a GP is handling their own management company, there has to be a segregation of duties, such as an accounts payable function, separate and apart from an accounting function," says Pollack. "There have to be checks and balances, an inputter, and a reviewer, and that number only goes up with more company employees, deals to track, and assets under

From the first swipe of a credit card

In a firm's early days, with so much to do, it can be hard to find the time for management company matters when fundraising is rightfully front and center

Management company needs crop up quite early, and quick fixes can plant the seeds for problems to come. "It all starts from day one, right when the firm is launched, when that first check is cut to form the LLC, or LLP," says Luis Gutierrez, a managing director with Gen II Fund Services. "And there are real benefits to getting the management company processes set up properly from the start."

Gutierrez argues that set-up includes such basics as a company credit card, to avoid using personal credit cards, creating a segregation between business and personal expenses. "We often have emerging managers who engage us early on in their search for a service provider. We are able to discuss their overall needs, provide them with checklist of required items and also discuss issues they may not have considered yet," says Dautanya Strachan, a managing director with Gen II Fund Services. "We can provide assistance and guidance in a variety of areas from obtaining an EIN, to setting up a bank account. This is especially helpful to clients as many are spinning out of larger firms where such infrastructure was already in place."

Beyond the basics, there are three elements for an emerging manager to consider in planning their management company solution: labor, tech and expertise. However, such matters remain relevant even on that sixth or 16th fund. And that's why it can be so difficult to gauge how many staff to hire, what technology to deploy and how to manage the processes. The best management company solution will be able to grow right alongside the firm.

management." This also requires the firm to assume the HR risks and responsibilities of that team, which can swiftly soak up the time of the internal CFO. And that's time that the CFO can't use to pursue more higher-level and more strategic initiatives.

Even if a firm taps an outsourced provider, it will need a financial staff in-house to partner with that third party. Service providers stress that GPs won't have to grow finance team exponentially, but firms will still need a qualified staffer to review deliverables and help craft the agenda.

Those labor issues alone might be driving some managers to tap outside service providers as soon as possible. But even if the GP is willing to build the team internally, that doesn't answer one of the biggest questions in management company processing: the right technology. Accounting software has been improving rapidly in speed and sophistication, with more promised leaps from AI and machine learning. That doesn't mean any of those cutting-edge solutions come cheap or are easily implemented by a single firm.

Tech bites

For budget-conscious GPs, QuickBooks might seem like a short-term fix for the management company, but it's a route rife with pitfalls. The issue is that institutional-grade technology can be too expensive for a single client to afford, leaving them to make do with a consumer option. And even if the GP is willing to pay the price, the internal IT staff will be the ones maintaining, upgrading and troubleshooting it, which should be considered part of the total price tag.

That price tag drops significantly when the institutional-grade tech is provided by a service provider, who can spread the cost across its entire client base. With regular practice, that service provider only gets better at onboarding and managing that tech, solving for the kinks or quirks that appear within the most robust systems. And the institutional-grade systems available right now have plenty to offer.

"The bar keeps rising for tech in our industry," says Pollack. "Our dashboards offer clients real-time access to all of their data, but not merely an extract of information that a client needs to sift through. A client's data is presented in a usable and customizable format that supports the needs of each client."

Pollack highlights the need for data to be flexible, so it can be manipulated into bite-sized summaries, meaning the client can devote time to analyzing information instead of compiling it. "We believe that technology for management companies shouldn't be a burden to bear, but an asset to tap," says Pollack.

The right systems can also alleviate certain tasks that can quickly overwhelm in-house staffs. "Without a third-party system, GPs will process their own 1099s, a deeply labor-intensive process that happens in January, precisely when GPs want to devote time to closing the year-end books and planning the year ahead," says Pollack. It's a repetitive, low-value process that should be automated, not just to free up staff, but to reduce human error, which is all too common in tasks like these.

And this doesn't even address data security for the management company, which can be a burden for IT staff to maintain. When they tap that third party, the internal IT staff's initial due diligence will address such concerns once, shifting the responsibility to the service provider from that moment forward.

Veteran insight

GPs readily accept outside tax and legal expertise, but the service providers for today's management companies also offer a wealth of experience in their discipline

"We have clients at all stages of maturity," says Michael Pollack, head of client delivery and innovation at Gen II Fund Services. "And that allows us to leverage the experience of long-tenured clients to those younger managers who are on their first or second fund but want to be ready for their 12th." Also, service providers will strive to deliver more sophisticated analysis and budgeting, cash forecasting and the like, as the client's business becomes more complex. It's not just manpower and tech, but the skills that come from mastering this particular element of the business.

Still, some GPs might be eager to stay lean, and muscle through the management company work in-house for the first few funds, assuming they can upgrade at some point in the future. But that may not be sustainable for reasons that have nothing to do with staffing or tech.

And the service provider is driven to invest and maintain the strictest protocols and security solutions, given the reputational risk of any such breach.

Anchor standards

If a firm finds themselves looking for an infusion of capital, they may court an anchor investor. "That anchor investor will be keen to look at the management company's books and can be as rigorous as any SEC audit," warns Gutierrez. "And even if the exam goes smoothly, they may require the GP utilize an outside service provider to service the company from that point forward."

The reasons for this include the rigor and validation that comes with a third-party provider. "Similar to our fund administration services, we have multiple layers of review, quality control and compliance checks internally for management company services, which means there are multiple eyes on everything we deliver, ensuring a clean, high-quality product to our clients," says Dautanya Strachan, a managing director with Gen II Fund Services. And for LPs nervous about tax or regulatory flare-ups, this can offer peace of mind.

> *"If a GP is handling their own management company, there has to be a segregation of duties"*
>
> **MICHAEL POLLACK**
> **Gen II Fund Services**

Never too old, never too early

More mature fund managers may balk at upgrading how they service their management company, since their approach has already worked for years. But growth brings volume, and that might eventually overwhelm the in-house back office staff, which may not get the same time or investment as the deal side of a firm – and that's not the manager's fault.

"Management company operations are not as core to a GP as sourcing high-quality investments and generating returns for LPs," says Strachan. "GPs can choose to run their management company operations in-house, but as scale and complexity grow, the time and energy required to properly run those operations start to compete with higher-priority items. This competition for time often leads to errors or missed deadlines." And there's no guarantee that a missed deadline or dropped ball won't court blowback from LPs or regulators.

Older firms might also be wrestling with legacy technology or labor-intensive processes that rely on the likes of Excel to handle their management company. The older the firm, the longer the paper trail will be. And that means even if the GP is open to upgrading its processes, it is going to take longer to migrate all that data into the new system. Service providers report having to often use forensics to map their way through old records.

It doesn't mean that more mature firms should shy away from upgrading, as the process may involve more time and attention, but is still viable. "The longer you wait, the more expensive it will be," says Pollack. "Conversions are hard and costly, and a prime example of where a GP doesn't want to spend their time."

That is why any shortcut taken today will eventually have to be paid for tomorrow. GPs may still prefer to handle their management company internally, but the standard of care is only rising, as LPs and regulators have less patience for error or informal processes. And that takes time, money and even creativity that could be applied to the firm's central focus: delivering outsized returns.

The same investors clamoring for administration beyond reproach aren't lowering their expectations for the bottom line anytime soon. ■

Q&A

Even before its first close, Braemont Capital outsourced the administration of both its funds and management company, says Steve Sims, the firm's COO and CCO

Like most best practices in this industry, the ideal time to begin them is at the firm's founding, and the second-best time is right now. Management company administration can be handled in-house when there's only a couple of funds, but eventually, the work requires more staff, technology and rigor than GPs may care to spend on it. We asked Braemont Capital COO and CCO Steve Sims about the firm's experience outsourcing management company administration from day one.

Q Why did Braemont Capital decide to outsource its management company administration from the very beginning?

A The decision was rooted in the fact that our managing partner Robert Covington already had experience outsourcing the administration of both the funds and management company to Gen II.

Robert spun Braemont out from Redbird, another New York and Dallas-based private equity firm, and brought with him the best systems, processes and controls from that organization. But we've found our own value in working with an experienced service provider, and that's because this is the first time I've served in this role at a private equity firm, and my controller is a CPA that has never worked in private equity before.

"My best advice about working with administrators is, make sure it's a true partnership"

We rely on Gen II not merely as another set of hands, but as a trusted adviser, given their wide range of clients and experiences to help us make decisions about our own infrastructure. For example, we just introduced a new LP portal, and they were integral in sourcing the right technology and ensuring a successful transition.

Q Since Braemont decided to outsource, how did the firm look at in-house staffing?

A Until December, I was by myself and that was hard. There's still plenty to do internally with capital calls, subscription documents and the like, not to mention feeling that I really wanted a second pair of eyes on all our work. We tapped Carolyne Baber as a controller, since she was a CPA with extensive tax expertise that I didn't have. She can tackle K-1s, expenses and a lot of the processes, and that's been a tremendous help.

Q What advice do you have for other emerging managers who are looking to outsource the administration of both the management company and its funds?

A First and foremost, establish a cadence for communication. We have weekly Thursday calls with Gen II, and that's done so much to keep administration matters from being postponed or neglected. We have a working capital line and financial statements due at specific dates, so these weekly calls ensure those deadlines never surprise us. Sometimes we only talk for five minutes, but it keeps us updated.

My best advice about working with administrators is, make sure it's a true partnership, with dialogue and real collaboration. We don't merely make requests of Gen II; we work together to find out what we need and how best to get it. ■

KEYNOTE INTERVIEW

Hand in hand

GPs need to ensure there's an effective collaboration between fund administrators and those handling the management company, says Michael Tesoro, a principal with Gen II Fund Services

The alternative asset industry has long embraced outsourcing, and with good reason. The economics make sense and competition among service providers has them constantly upgrading their tech and talent. As much as these firms can lighten the load for a GP, the best outsourcing relationships still require some thought, and some work from their clients. A hands-off policy with service providers can court misunderstandings or worse, between client and vendor, and among the vendors themselves.

This is especially true with regards to the relationship between the staff servicing the management company and the provider administering the funds. It may not be as obvious to foster a relationship between the two, but like most best practices, it's easy to discount until something goes awry.

Given LP demands and regulatory oversight these days, there is little room for error, says Michael Tesoro, a principal with Gen II, who has long worked in fund administration.

Q It can be easy to overlook all of the ways that the management company and funds need to collaborate together. What are some of the events or situations that require the administrators of both to work in tandem?

We clearly have four key events of the year: three quarterly reports and the annual reporting, and in many ways, there's a clear process and timeline. There are also a number of times when the GP or the fund manager will need information and collaboration of both teams: the investor conferences, fundraising, significant LP meetings and the annual meeting all require compiling and aggregating data for these meetings and presentations.

Another key area of focus is the SEC exam, which for us is the final test to see if everyone is doing their job correctly. There's no hiding in those situations. They either have the data to meet the SEC's requests, or they don't.

We pride ourselves in proving our capabilities when the stakes are high, such as that regulatory exam, the important LP update or that fundraising meeting that can make all the difference for the future of that GP.

Q How can a GP gauge if those servicing their funds and those servicing the management company are collaborating effectively?

The relationship has to have all the standard signs of a positive working relationship, which include effective communication, corroboration and trust. These may all sound intangible, but there are ways to tell if they're in place. Maybe they don't finish each other's sentences, but in group calls, they already know each other's needs and when those needs have to be met.

This means that no one is asking a second or third time for a set of deliverables. This may be counterintuitive, but when that collaboration is humming, the GP doesn't need to manage the relationship any longer and can take a more hands-off approach. But that kind of trust doesn't just appear out of nowhere; it's cultivated by the GP, and the staffs servicing the management company and the funds.

Q Let's say the GP starts out with everyone on the same page, but perhaps one side or the other doesn't maintain adequate rigor in process or communication. Are there any red flags that something has gone off the rails?

As soon as someone in the process says, "Hey, we needed that yesterday," that's a red flag. This implies someone was unaware of a deadline, or unable to meet it. So much of the administration of both funds and the management company involve recurring processes, timelines and deliverables; these shouldn't trip anyone up. The other thing is any misunderstanding on a group call, where it's clear the parties haven't been updating each other on a given situation or project.

Q It's been popular for emerging managers to start their firm by handling the management company internally, and outsourcing fund administration. How do these managers set the relationship between the two up to succeed?

When you have a GP that has a fund administrator and an internal staff handling the management company, there has to be a regular cadence that's clear and defined. This means standing calls, calendar deliverables, recurring meetings and additional touch points as needed. Not every meeting or call needs to be three hours; sometimes it can be a simple 15 minutes. But these guardrails ensure nothing gets missed.

It's good for the GP to check that this cadence has been established, but they shouldn't have to micromanage the relationship. The GP should trust that when they walk away, the fund administrator and management company staff will talk without them. Ideally, they'd develop an informal pattern of calls and emails as needed.

> *"We're going to better understand the unique needs and challenges of that particular client because we're handling both"*

It's always a balance since it can start to feel robotic if every meeting is overly formal. In the best-case scenario, a shorthand is developed, which adds efficiency and can even spark some useful innovation between the two. A perfect example is when the management company staff notices a stack of invoices arrive in the last week and gives the fund administrator the heads-up. Those informal connections are the best sign that the relationship is thriving, and the GP can trust both sides of that relationship.

Q Gen II offers services to both the funds and the management company, so what's the benefit to having both under the same roof?

The GP does not have to micromanage the relationship. There's a consistency in reporting, in efficiency, in scalability, since everyone is using the same standards, the same processes and the same technology for both. The collaboration has already been refined by us in-house, and we're going to better understand the unique needs and challenges of that particular client because we're handling both. Let's say I get off the phone with the CFO of one of our clients and I realize there's an issue relevant to the management company side; all I need to do is walk down the hall to discuss it.

And that shared tech stack also allows the GP greater control over their data across both the funds and the management company. It just makes that collaboration so much easier. When we do vendor payments, and the client wants to bill those to funds in real time, we can, whereas they might normally only do them quarterly. We're constantly finding ways to improve the work streams, which also reduces the chances for human error.

We also have a special quality control team, outside of the fund or management company teams, that independently verifies the work of both before sharing with the client, adding another layer of review. The QC team only gets smarter about the issues that come up most often with that client, making them more efficient over time. In the end, we know the best relationships – between client and vendor, between vendors, even among staff at a single vendor – never stay static and have to be constantly improved. ■

Well-run funds. Gen II

COMPANY OVERVIEW

Gen II Fund Services, LLC is the largest independent, U.S. based, private equity fund administrator, administering over $850B+ of private capital. The Gen II team is the longest-tenured, most experienced team in the fund administration industry. Our senior management team has more than 25 years of experience and are recognized as leaders in private equity fund administration. Our dedicated client service teams, led by a Principal with an average of 15 years of fund administration experience, provide our clients with world class service and expert guidance.

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Q&A

For more than a decade, Corsair Capital has outsourced the administration of both its management company and funds, so we sat down with its CFO, Paul Cabral, to discuss how that practice has fared in the long term

Any industry is prone to fads in best practices. But what might have been celebrated as a "common sense" tactic years ago can calcify into a tradition that can't meet modern demands. That is why best practices should be regularly vetted to make sure they remain relevant.

Outsourcing management company administration is one trend in private markets that has been around for quite some time. The benefits it provides are certainly compelling, with the promise of cutting-edge tech, rigor and expertise. But what does that at practice look like after a decade or more? Here, Corsair Capital CFO Paul Cabral shares his firm's experience outsourcing management company administration since 2009.

"Outsourcing allows us to stay efficient with our headcount, while letting us hire key people internally"

Q How has Corsair found its experience outsourcing both its management company and fund administration?

A I joined Corsair back in 2017, and we'd already been using Gen II as an administrator of both the funds and the management company for years. I've worked with numerous administrators over my career, and when I arrived, the work was well handled, so there was no reason to do anything differently. I will say that over time, they've upgraded technology as it makes sense, but beyond that, not much has changed.

We've taken full advantage of their internal processes and controls, and of course, their additional bandwidth as needed. We try to empower them as much as we can, and I think that speaks to the trust that's been built over time. All those years have also created a great informal communication dynamic, where we're always in contact with one another and feel free picking up the phone or sending that email about anything that's come up.

Q How do you view the role of internal staff when you're outsourcing to Gen II?

A As much as Gen II does for us, our internal staff is ultimately responsible for the work. Outsourcing allows us to stay efficient with our headcount, while letting us hire key people internally, which makes our whole organization stronger.

Q Any advice for a CFO exploring the possibility of outsourcing their management company?

A I'd say it's best to begin outsourcing when the firm is first starting. There's just an enormous upside to tapping the industry expertise, the latest tech and the market intelligence. Service providers have multiple clients of different sizes, vintages and strategies, so they can share the best practices from all of them. ■

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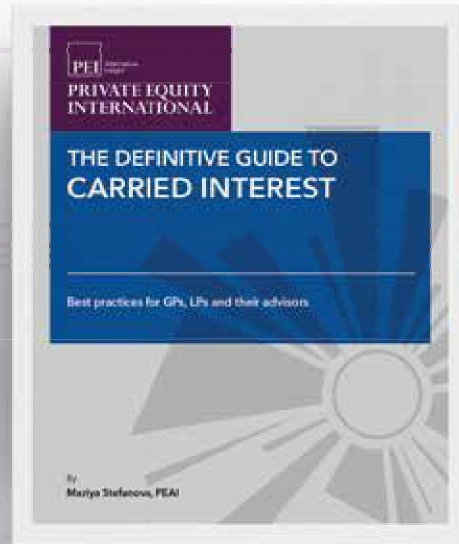

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