Gen II View **GPs stay competitive via wise spending and strategic focus**

Expert analysis by **Robert Caporale**, President – Strategic & Digital Solutions, Gen II Fund Services

With increased competition for fundraising, management companies are focusing on aligning their strategies for resource allocation and internal expenses with investor expectations, showcasing a clear value proposition and demonstrating strong track records. As firms manage unrealized capital and navigate the intricacies of regulatory scrutiny, there's a growing expectation for increased transparency.

Internal expense ratios within private equity firms exhibit surprising variability. Benchmarking these expenses becomes crucial for obtaining valuable insights into peers' average expenditures on back- and middle-office capabilities. This information is particularly significant as management companies face increasing scrutiny to enhance efficiency and comply with new regulations while scaling their business.

Talent compensation is a top priority

Gen II's analysis of management company spending segmented firms into three categories based on assets under management, but one thing rang true no matter the size – firms are focused on investing in talent and creating operational efficiencies. As the private equity landscape becomes more complex, there is an increasing demand for skilled professionals. Management companies are investing in talent development, training and attracting individuals with diverse skill sets to meet evolving industry needs.

Respondents across AUM categorizations on average reported 69 percent of their spending expenditures going toward talent compensation. From the $0-$499 million category to the $1 billion-plus category, there was less than a 10-percentage point difference when it came to compensation spending, highlighting that no matter the size of a manager, talent and retention are the top priority.

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Prioritizing internal structure aligns with LPs' expectations

The changing needs of private equity management companies reflect the evolving landscape of the industry, influenced by various factors such as market trends, regulatory changes, technological advancements and investor expectations.

Management companies exhibit a prudent approach in their spending strategies, emphasizing risk avoidance. Even with a marginal uptick in post-pandemic spending on travel and entertainment, the overall percentage allocated to this category has decreased from 5 percent to 3 percent since 2016. This trend underscores the ongoing commitment of fund managers to prioritize internal structure. It serves the dual purpose of satisfying limited partners and aligning the overarching goals of the firm with the activities of general partners. This reflects a continuation of fund managers focusing on strategic alignment and resilience in the face of evolving circumstances.

Strategic focus leads to greater insights

Certainly, a significant number of private equity managers often perceive activities beyond the realms of sourcing new deals, fostering portfolio company growth and executing investments as distractions from their daily priorities. However, amid a progressively competitive environment for fundraising, limited partners are now closely examining back-office capabilities. ILPA's revised version of its standard Due Diligence Questionnaire extensively explores aspects ranging from management company economics to cybersecurity, compliance protocols and the utilization of an independent fund administrator by firms.

Increasingly, management companies are focusing on robust data management and analytics tools to derive valuable insights, improve decision-making and enhance operational efficiency. Adaptability and a proactive approach are crucial for private equity management companies to thrive in the dynamic and competitive landscape of the industry. ■