GP Fund Solutions®

The Emerging Manager's Guide to Private Equity Fund Administration

Overview

Emerging fund managers face many challenges within the private fund administration realm. Fierce competition and evolving regulations increase the complexities, necessitating innovative strategies to drive returns, ensure compliance, and enhance their chances of success.

Private fund administration has always been a competitive industry, and it becomes more so every year. In the United States, private equity firms manage more than $6 trillion in assets[1] across every industry, including healthcare, housing, retail, energy, and more. Emerging fund managers play a crucial role, yet they often face a daunting test to establish credibility within the space, build a cohesive team, raise capital, and offer significant value to investors. Differentiating themselves is critical to standout in the competitive arena.

In 2010, an estimated 4,300 private equity firms existed in the United States.[2] In 2023, data from IBISWorld reveals that the number has swelled to more than 14,000[3], an increase of more than 225% over the course of 13 years. Asset growth has not increased at the same rate, creating increased pressure on professionals striving to buy and yield excellent returns on those assets.

Along with other factors, such as inflation and the growing complexity of both transactions and regulations, fund managers — both emerging and established — must find ways to increase operational efficiencies and strategies to navigate this complex environment.

This is where outsourcing private fund administration shines. Partnering with the right third-party allows emerging fund managers to focus on the business at hand. It can also reduce regulatory risks and ensure compliance with the complex regulations that exist within the private fund landscape. Fund admins also assist with establishing best practices based on years of experience and in line with the current market, which are scalable, predictable, and minimize operational and reporting risk.

Many administrative tasks are ideal to outsource, freeing fund managers from back-office tasks and enabling them to focus on building strong relationships and making strategic investments. To aid emerging managers in building thriving careers and growing with success, we've compiled this guide to focus on critical fund administration considerations.

1 ProPublica. "What Is a Private Equity Firm?, https://www.propublica.org/article/what-is-private-equity." Accessed January 17, 2024. **2** Institutional Investor. "Private Equity Has Become More Competitive. Here's How Managers Can Stand Out, https://www.institutionalinvestor.com/article/2bstptje8jk6fiucstyio/portfolio/private-equity-has-become-more-competitive-heres-how-managers-can-stand-out." Accessed January 18, 2024. **3** IBISWorld. "Private Equity, Hedge Funds & Investment Vehicles in the US, https://www.ibisworld.com/industry-statistics/number-of-businesses/private-equity-hedge-funds-investment-vehicles-united-states/." Accessed January 18, 2024.

Capital Calls and Distribution Management

Beyond understanding the structure of private equity funds, emerging managers must gain a strong foundation in cash flow management. As emerging fund managers approach capital calls and distributions, the need to effectively handle investors' expectations is paramount. Third-party private fund administrators can ensure firms follow the best practices in accounting along with aiding in capital calls and distribution management.

First, it can be helpful to understand the process from an investor's standpoint. The timing of the capital calls is not set and doesn't provide the investor with much notice prior to the call being due. For that investor, having strong cash flow metrics to refer to can help them better understand how much capital they should hold in reserve and the amount they can safely and strategically invest or reinvest.

In exercising their right to drawdown investor capital, the GP (General Partner) can pay expenses, management fees, and make investments. However, it's essential that LPs (Limited Partners) have a clear idea of how their capital will be deployed to ensure investors' needs are met and they know how to manage the capital they committed. To do so, fund managers must develop an effective strategy.

Calling capital can impact the internal rate of return (IRR), but emerging fund managers should focus on their cash-on-cash returns to optimize cash flow. Creating a regular capital call pace and schedule can benefit fund managers and LPs alike. Working with third-party private fund administrators can aid in this task.

GP Fund Solutions has a team dedicated to capital activities. This team is entirely distinct from the primary accounting team, which helps avoid confusion and ensure accuracy from specialized experts. The GP Fund Solutions' team relies on a combination of state-of-the-art technology and human review for consistency across processes, including waterfall models. This method of allocating returns across the pool of investors provides incentives to generate increasing returns. The terms of waterfall model usage will be outlined in the fund's partnership agreement to ensure all parties agree.

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Efficient Investor Reporting

Another cornerstone of private equity fund administration is investor reporting. For emerging fund managers, that means routinely updating LPs with ongoing fund performance updates and fundraising details. Reporting is the linchpin to fostering positive investor relations, an element so critical to fund managers that some devote an entire department to it. Providing clear, consistent, and transparent communication is essential, as is regular reporting. Responsibilities also include sending capital activity notices and providing supplemental investor reporting, such as ILPA-compliant templates.

This is a crucial tool that investors use to make informed decisions on a go-forward basis. However, the practice can be inherently time consuming and challenging. Data from the Allvue Private Capital Survey 2023 - Meeting the Market Moment shows that seven out of 10 GPs list investor reporting among their chief operating challenges.[4] Keeping pace with evolving reporting requirements and best practices is an essential element. Security, including setting up password-protected, secure investor portals, is a must. Sifting through the massive amounts of data that most fund managers handle and keeping it updated may be among the primary challenges that fund managers face. Managing communications, meeting investor expectations related to timely reporting, and navigating cybersecurity concerns are all paramount. Providing clear, easy-to-read details, quarterly reports, and sharing the waterfall status are among the best practices to not only enhance transparency but also build trust between emerging fund managers and investors.

Fund administrators can tackle those challenges on behalf of fund managers, ensuring all best practices are followed and stringent security protocols are in place. With the right partner, emerging fund managers can leverage state-of-the-art tools and technologies. For example, Allvue Systems, trusted by more than 400 global clients, is the backbone of GPFS reporting. It provides access to vital business intelligence, customized dashboards, and detailed custom reporting. These features allow fund managers and GPs to streamline their processes and meet the challenges of the evolving private equity reporting landscape head on.

GPFS also partners with Passthrough for investor onboarding. Passthrough offers an all-in-one platform solution, simplifying the subscription document process for investors by incorporating easily replicable and verifiable identity information for future use. Alongside subscription documents, Passthrough provides a comprehensive KYC & AML product, facilitating the efficient collection of investor information and screening against sanctions lists to ensure compliance for fund managers

4 Allvue. “Our Guide to Investor Reporting, https://www.allvuesystems.com/resources/our-guide-to-investor-reporting/.” Accessed January 22, 2024.

Navigating the Regulatory Landscape

In the past, private equity was seemingly lightly regulated, but the waters are becoming increasingly complex. Until recently, governments paid less attention to private equity firms compared to brokerages and commercial lending institutions. The massive growth of private equity over the past decade has fueled reforms and tightened regulations.

In August 2023, the United States Securities and Exchange Commission (SEC) approved new rules, ushering in new, more stringent regulations. The changes are designed to provide added protection for investors and to limit fund managers' ability to charge expenses to their clients. The changes also aim to halt the backroom, confidential deals that allowed only some investors to be privy to top-tier deals. The new requirements established under the Private Fund Advisers Rule require GPs to disclose all fees, issue detailed quarterly statements, and meet stringent reporting requirements. Every private fund must undergo an annual audit, and any secondary transactions must be accompanied by a fairness or valuation opinion provided to the fund illustrating the fair terms of the deal. Additionally, the SEC is taking a more proactive approach to emerging fund managers and is performing examinations within their first year. GPFS can assist with establishing SEC-compliant best practices from the beginning and can assist fund managers when these examinations occur.

These are just a few of the emerging rules in the U.S. Other countries, including the European Union and the United Kingdom, who are also tightening the reins on private equity regulations. For emerging fund managers, the evolution of regulatory requirements is creating additional pressures and administrative challenges.

Navigating the path forward requires focused strategies, including achieving increased agility and operational efficiency. Additional strategies include increasing transparency and reporting capabilities and gaining a robust understanding of the investments. Investors are also increasingly demanding environmental, social, and governance (ESG) monitoring, so emerging fund managers would do well to incorporate it into their capabilities.

Emerging fund managers need to devote substantial infrastructure and time to keep pace with the changes and ensure compliance. Common pitfalls include struggling to extract data-driven insights, maintain confidence in the face of tumultuous markets, and comply with all new regulations. To avoid these challenges, it's essential to streamline back-office operations and increase efficiency.

The growing complexity of the deals themselves, in addition to the regulations set forth across the world, can be managed with efficient fund administration. Administrators have expertise and teams devoted to remaining current with all laws and regulatory issues. Additionally, at GPFS, experts provide critical data for legal filings and collaborate with compliance firms and attorneys.

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Building and Maintaining Investor Relationships

Reporting is only one of the many elements necessary for building lasting relationships with investors in this dynamic, competitive environment. Emerging fund managers should begin creating strategies that start before LPs are even targeted. For example, by researching target investors and focusing on those with the time and capacity to commit to an emerging fund, emerging fund managers can rest assured that they are spending their time wisely. Additionally, by focusing on details like investors' prior commitments, average commitment amounts, and current rosters, fund managers can customize their investment pitches more effectively.

Providing tailored pitches is an excellent beginning. Building long-term relationships requires fund managers to develop a deep understanding of LPs' needs and expectations. Overcommunication is among the best practices emerging fund managers can develop. Investors want updates about fund performance, and they demand honesty. Even when performance is struggling, it can be a positive factor. Showing vulnerability and transparency helps build trust and strong, empathetic relationships.

The goal is for investors to continue coming back. Developing strategies for effective communication to ensure GPs and LPs are aligned is vital. LPs have more leverage in the fundraising negotiations than previously was the standard. GPs are also offering better economics, increasing their own commitments to the fund, and are even offering stakes in the GP entity.

Some of the communication best practices include the following:

Understand What LPs Want: What type of numbers and metrics do investors want to see in reporting? For many, its core metrics like IRR and total value to paid –in capital (TVPI) but increasing numbers of investors also require measuring ESG considerations and economic impacts of the funds.

Prioritize Transparency and Authenticity: LPs want to work as partners in the process. From fundraising and throughout the fund's term, every communication is an opportunity to strengthen the quality of investor relationships. It shouldn't be about selling investors on a fund but demonstrating that you value the LP beyond that initial commitment of capital.

Communicate with Empathy: To understand investors, it's critical to talk to them and ask deep, probing questions about their portfolios, the gaps they want to fill, the investment timelines they are comfortable with, and any challenges they face. Discover more about their communication preferences, risk-tolerance, and what they expect from GPs.

This is another area where outsourcing specific tasks to a private equity fund administrator can add value. For example, fund administrators can help maintain accurate address and contact records and track financial transactions. GPFS aids clients in setting up policies and procedures that support operational due diligence which can impress potential investors.

Operational Best Practices

Emerging fund managers often feel as though they face an uphill climb. Closing complex deals, tightening regulations, and navigating a fiercely competitive market necessitate streamlining and optimizing operations. Doing so also provides fund managers with a distinct advantage and another avenue for value creation.

One way to approach operations is by examining industry trends. For example, EY's 2023 CEO Outlook Pulse Survey revealed that 70% of CEOs acknowledge the need to incorporate artificial intelligence into their operations.[5] This emerging and disruptive technology can help automate some administrative functions, aid in performing due diligence, and even help with reporting. The survey underscores the need for fund managers — whether they choose to use AI or not — to explore technologies that can enhance operations and add confidence to investors.

Trends are not the primary focus. Many of the day-to-day tasks that emerging fund managers will engage in include building financial models, researching investments and conducting due diligence, and creating pitches and presentations. Sourcing deals requires research into how the industry works and who the stakeholders are. However, this critical activity goes beyond initial sourcing. It requires researching industry trends and learning about various competitors, meeting with management teams, and building relationships. Once fund managers find possible investments, they must perform analysis and collect data to assess its viability. Negotiating deals, drafting term sheets, attending board meetings, and communicating with investors are also among the most fundamental tasks.

That doesn't even account for back-office tasks, including accounting and administrative chores. For some fund managers, keeping administration in-house makes sense. However, many firms are moving toward outsourcing administration and non-investment tasks to fund administrators like GPFS. Doing so facilitates the development of an efficient operational framework and allows fund managers to leverage some of the latest technologies.

When outsourcing private equity fund administration, choosing the right partner is essential to achieving the desired results. For example, GPFS has low employee turnover, and we never outsource. By handling everything in-house and having a dedicated team, fund managers can expect consistency in the service they receive without having to frequently retrain administrators.

Additionally, senior GPFS personnel participate in direct client communications, lending their expertise and the viewpoints of professionals who understand the challenges emerging managers face. GPFS professionals have robust knowledge and expertise, often with more in-depth business knowledge than new CFOs. The outsourced team can act as a repository for historical information and apply healthy skepticism due to familiarity with the client.

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5 EY. "CEO Outlook October 2023 on AI Strategy, https://www.ey.com/en_us/ceo/ceo-outlook-global-report." Accessed January 23, 2024.

Future Outlook

Investors remain reluctant to invest in emerging fund managers, exacerbating the challenges that GPs face. According to Private Equity Internationals 2024 LP Perspectives study, **33%** of investors are less likely to invest with first-time fund managers than established, experienced fund managers. This figure is up from **26%** the year before.[6] High competition and evolving regulations add to the pressure. At the same time, opportunities abound, and the future of private equity and emerging managers remains bright.

To be successful, it's essential to gain a solid foundation in how to structure funds and the available resources that can provide deeper insights into the market. Fund administration is a vital element, with operational efficiency mission-critical to add value to potential investors. Complex, evolving regulations and investors' growing need for transparency, honesty, and strong relationships tie into every aspect of the emerging fund manager's operational framework.

Partnering with a private fund administrator like GPFS can add additional credibility and a fresh set of eyes that can benefit emerging fund managers and save on costs. According to data from a 2022 Forrester Consulting study, **private equity firms that outsourced saved $3.9 million** over three years.[7] Outsourcing offers access to advanced technology and experts devoted to staying up to date on evolving and emerging regulations, laws, and compliance issues.

GPFS can provide invaluable resources, including advice from senior leaders who understand the private equity landscape and the pressures that emerging fund managers face.

Learn more about the complete fund administration services GPFS provides, the attributes that makes it stand out, and the value it has to offer by visiting **gpfs.com**

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6 Private Equity International. "LPs Remain Cautious with First-Time Funds, https://www.privateequityinternational.com/lps-remain-cautious-with-first-time-funds/." Accessed January 23, 2024.

7 AIMA. "New Research Quantifies the Benefits of Outsourcing, https://www.aima.org/journal/aima-journal---edition-131/article/new-research-quantifies-benefits-of-outsourcing.html." Accessed January 23, 2024.

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