Brackendale
CONSULTING

The Cost of Playing the Game: The Brackendale Private Equity LP Sentiment Survey H1 2023

in partnership with

IQEQ
Know how Know you

Why

Brackendale works with its fund manager clients to help them market themselves and their policies in the best possible light to LP investors, while IQ-EQ focuses on helping fund managers and investors commit capital in a sustainable and compliant manner. Together, we wanted to explore LP perspectives on ESG and the viability of fund manager compensation levels in a changing macro-economic climate.

Who

LPs surveyed hail from across Europe, North America, and Asia. They comprise a mix of pension funds, insurance companies, family offices, and fund-of-funds from our extensive contact network.

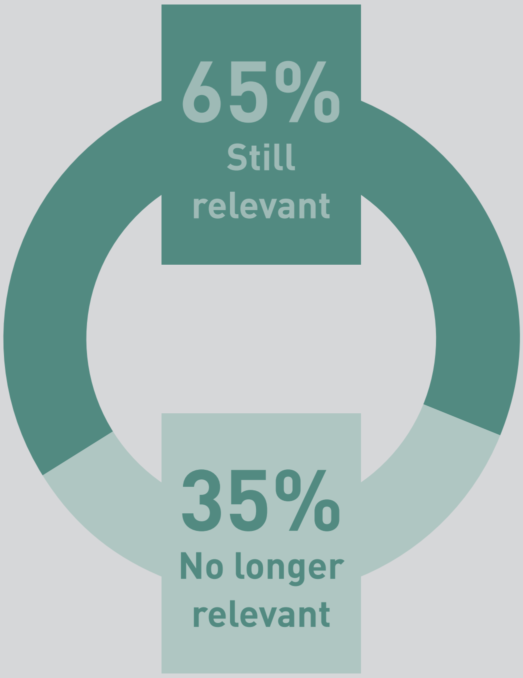
What

Questions in our survey were designed to explore LP reactions to the costs inherent in the private equity fund investment process, and whether current GP compensation levels are acceptable in a higher interest rate environment.

Key findings

A resounding majority of LPs surveyed thought that GP compensation should be linked to ESG-related incentives. LPs largely felt they held very little influence in fundraising negotiations. While a third of LPs questioned the relevance of the 2:20 private equity fee model, a fund's track record and team were deemed more important than fees.

Q1. Is the 2:20 fee model still relevant?

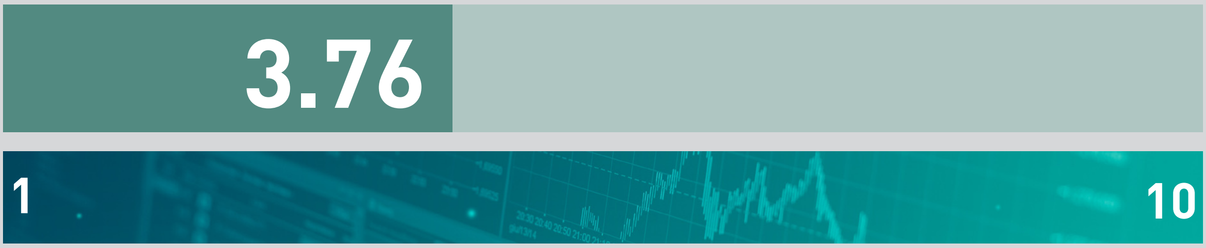


> **"The fees are always too high, but if we can get a 2x money multiple and a 20% IRR net, we have decided to accept the fee levels"**

While **65%** of LPs surveyed deemed the time-old 2:20 fee model to be still relevant, **the remaining third** of LPs considered it no longer relevant. A chief criticism was that the 2% management fee should be paid to fund managers regardless of the fund performance. One solution was to adjust the fee level accordingly: "The fees are always too high, but if we can get a 2x money multiple and a 20% IRR net, we have decided to accept the fee levels," commented one LP. Another suggestion was that the carried interest rule should be adjusted to avoid LPs having to pay for low performance (i.e. <2.2x TVPI).
Many LPs who took issue with the 2% management fees described them as excessive for those working with larger funds. Although some LPs believed that the concept of 2:20 was still valid for certain funds, in other instances they considered it had become a "profit centre" now that GPs are coming back to the market faster and raising bigger funds. One LP suggested tailoring the rules to make them appropriate to the fund size and strategy, rather than being simply imposed and accepted as the norm. It was generally agreed that a more competitive fee structure would help incentivise LPs to invest and ensure GPs are motivated to produce robust performance.

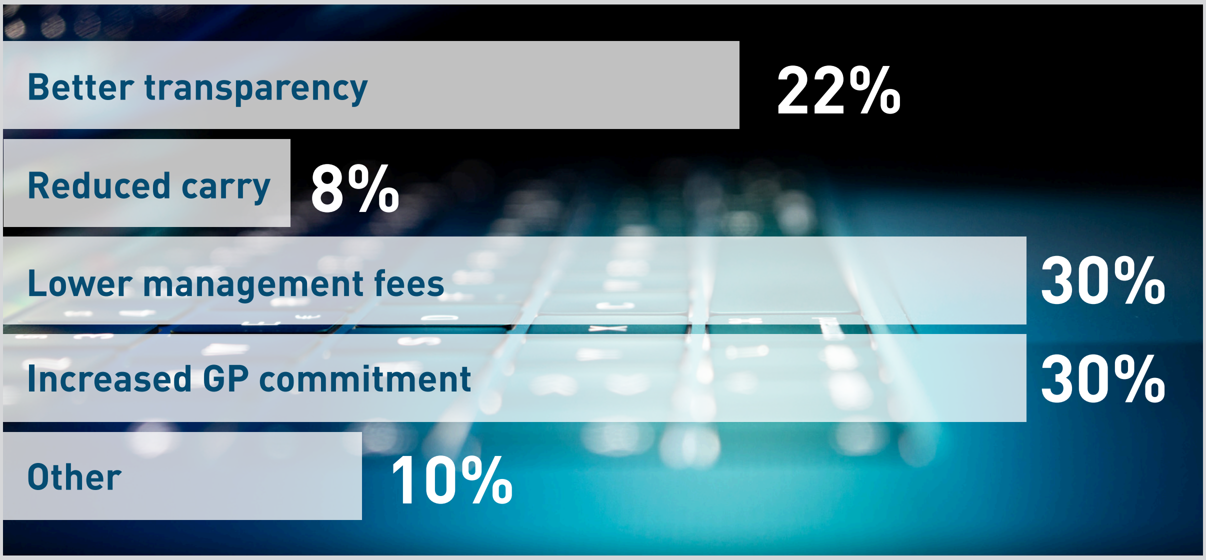
Q2. How much influence do you (LP) have when negotiating fees? (1 being a little, 10 being a lot)

When asked how much influence surveyed LPs felt they had when negotiating fees, the average answer was **3.76/10**. This rate indicates that LPs hold relatively little sway when negotiating fees, further highlighted by the fact that more than half of participants answered 2.5 or less.



Q3. In which single area would you like to see improvement?

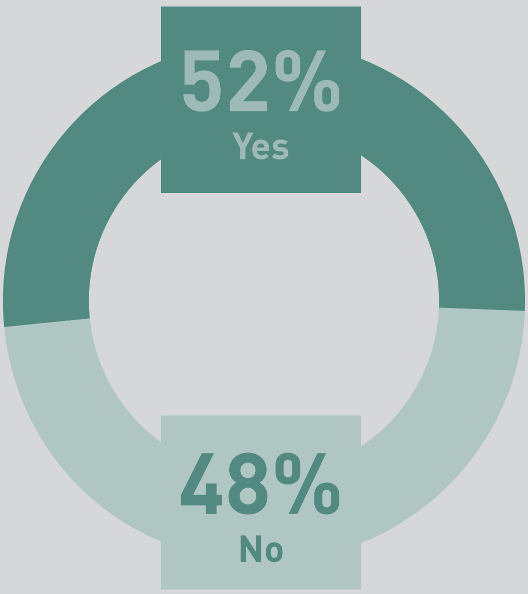
Nearly a third of LP respondents stated that they would elect to have lower management fees. This would clearly provide more financial incentive to LPs. **Around a third** of respondents would also choose to have increased capital commitment from GPs, which would make them more likely to enter into discussions. **A fifth** of LPs would prefer to have better transparency from their investee funds, and a mere **8%** would elect to have reduced carry. The remaining respondents ("other") would choose to focus on other improvements, such as lower or fixed fund expenses, tiered carry, or caps on fixed fund expenses.



Q4. How would you rank "market opportunity, fees, track record, and teams" in importance in fund due diligence?

The results found that, when considering potential investee funds, **LPs prioritised teams and their track records, both receiving nearly equal scores**. This signifies that when LPs are looking at potential investees, they are most likely to pick those with strong teams and track records. The results revealed that when compared to other factors, such as performance and investment focus, fees were almost unanimously deemed least important.

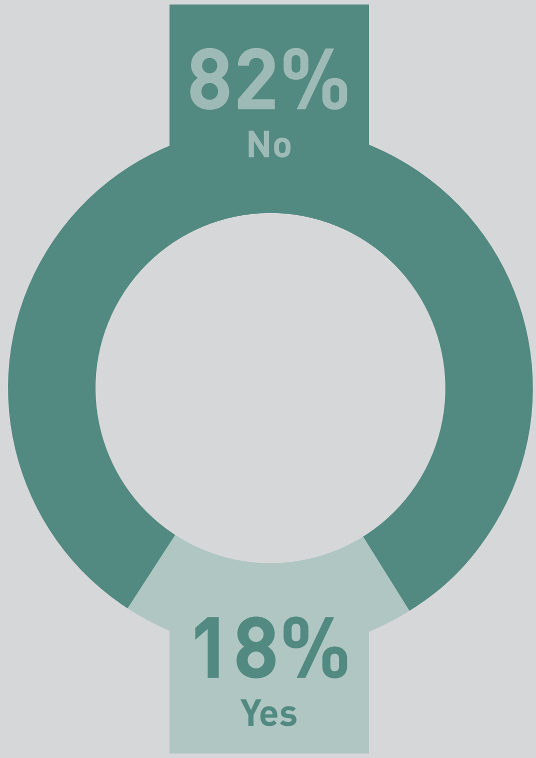
Q5. Should GP compensation be linked to ESG goals?



Some **52%** of LP respondents said that GP compensation should be linked to ESG goals. Of these, **a quarter** thought that that any such link should be in line with ESG goals focused exclusively on environmental objectives, namely the reduction and elimination of carbon emissions: specifically decarbonisation and net zero. The remainder of investors responding 'yes' thought that GP compensation should be specifically linked to KPIs of the fund and its portfolio companies, or a mix of other factors.

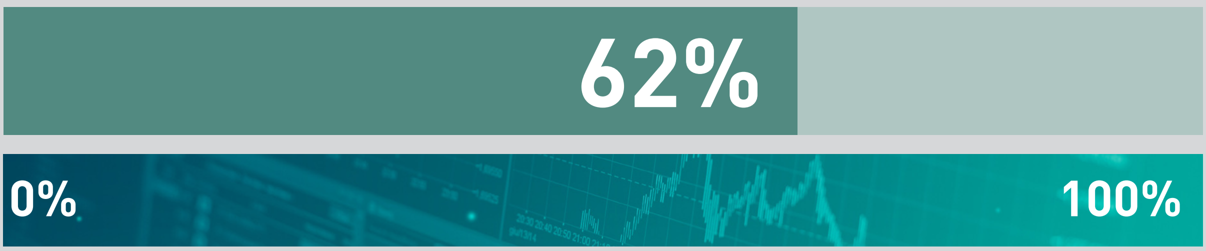
Q6. In today's higher interest rate environment, are you challenging GPs to increase the preferred return/hurdle rates on new funds?

A significant majority of LPs indicated that they are not challenging GPs to increase the preferred return and hurdle rates on new funds in today's climate. Amongst the **18%** suggesting it should be changed, most LPs cited a 10% hurdle rate, with a few mentioning it should go back to 8% for those GPs who had lowered the hurdle historically.

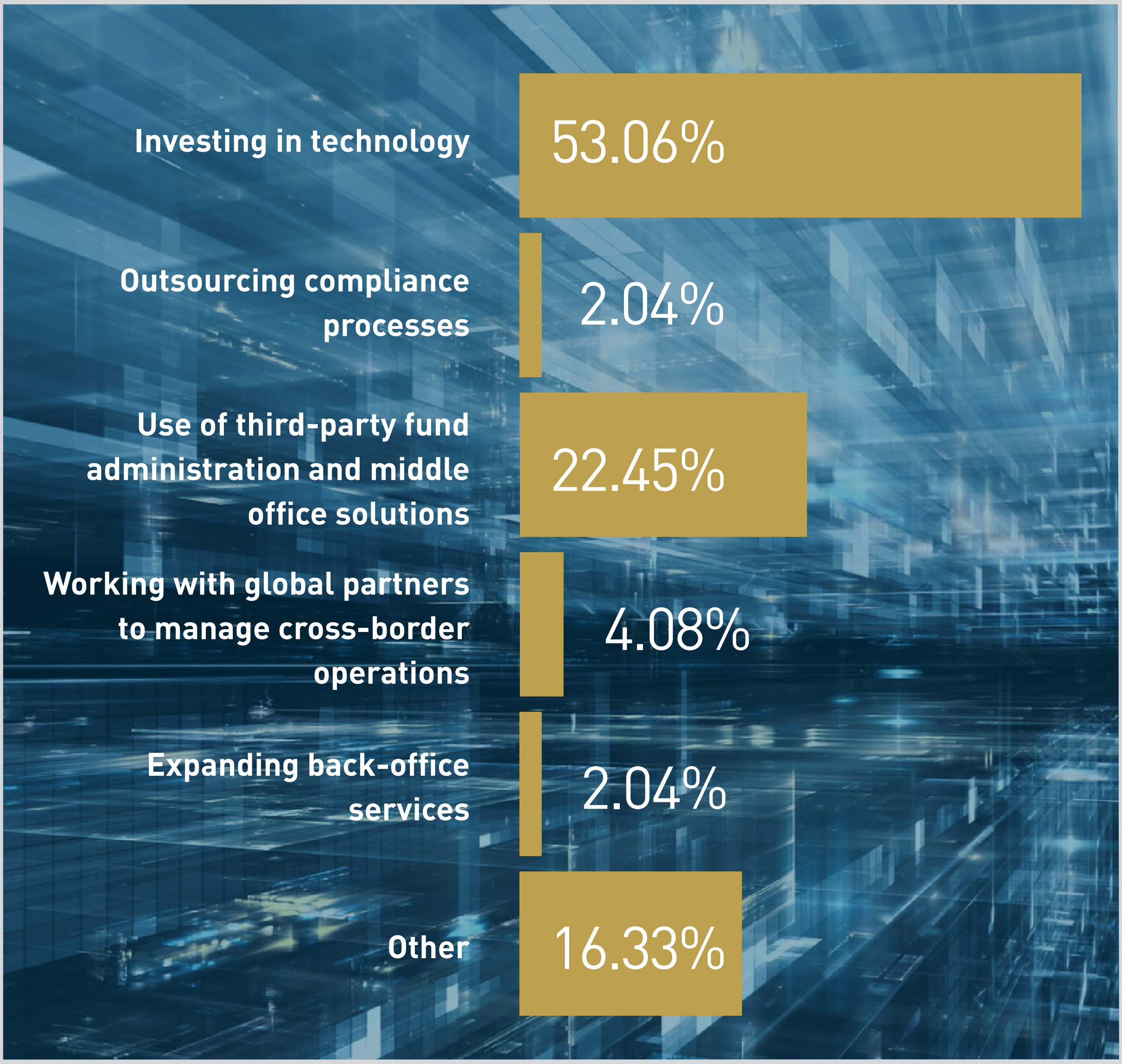


Q7. Do GPs provide satisfactory access to portfolio and performance data?

With answers ranging between **12%** and **100%**, our surveyed LPs expressed an overall satisfaction rate of **62%**. This shows LPs vary enormously in their satisfaction with access to the portfolio and performance data provided to them by their GPs.



Q8. What is your preferred way for GPs to keep costs down?



More than half of LPs said that their preferred way for GPs to keep costs down is by investing in technology. Meanwhile, **around a quarter** expressed that they preferred for GPs to use third-party fund administration and middle office solutions, and only a few said that they preferred outsourcing compliance processes, working with global partners, or expanding back-office services. The remaining **16%** of respondents preferred other processes that were not listed, such as lowering management fees in exchange for higher carry, reducing unnecessary compliance, accepting lower profits on excess fee incomes and having more automation.