

CSC

The Future Private Capital CFO 2023

Driving change amid heightened complexity

Growing optimism despite rising demands

Private capital leaders expect their lives to become significantly more demanding over the next few years. They predict growing calls for transparency from investors, regulators, and society at large. And they see diversification of geography and assets as the way to remain competitive in a more complex market.

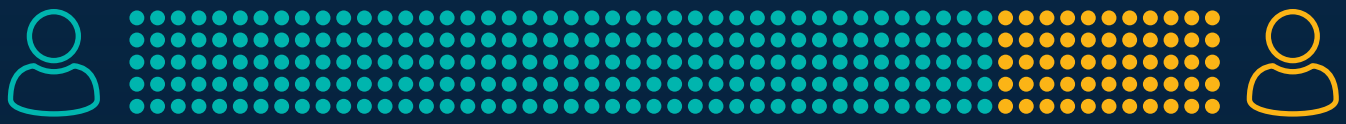
Fund structures will become more complex to achieve what is expected. We believe, and the data supports, that there will be increased use of special purpose vehicles (SPVs), hybrid funds, and credit facilities to achieve diversification. But private capital leaders naturally worry about how they will manage this activity with legacy technology stacks and a talent crisis.

This is the third successive year that CSC, in partnership with Global Custodian, has canvassed the views of private capital leaders, and there's a contradiction at its heart. General partners (GPs) know they need to work harder and smarter to achieve their ambitions, and acknowledge they face significant challenges in recruitment and retention as well as in implementing the technology they need. Some are considering growing their outsourcing and co-sourcing models as solutions. Many might not have a choice.

For this year's edition, we polled 210 GPs, mostly CEOs, CFOs, and COOs or their direct reports, on the changing nature of the private capital industry. The survey ran through May and June 2023.

Most respondents were from the U.S. (71.4%), with others from Ireland, Australia, New Zealand, Canada, and the U.K. Nearly half (46.8%) were from smaller funds with less than $1 billion in assets under management (AUM), though a significant number had more than $10 billion AUM.

We also polled 55 limited partners (LPs) for their perspective on the same themes, and their answers support predictions of growing complexity. They want more self-serve functionality, a greater focus on more complex fund structures, and more information on funds' hiring and retention policies. Many want live or daily updates on portfolio performance or operational efficiency. The onus is on GPs to meet these demands.



We polled
210 GPs
& 55 LPs

Most respondents were from the U.S. with others from Ireland, Australia, New Zealand, Canada, and the U.K.



Which of the following would influence your opinion of your fund GPs?

More customer-facing self-service functionality

Influence positively (%)
89.09

Influence negatively (%)
7.27

Neither (%)
3.64

Greater focus on more complex fund structures

Influence positively (%)
74.55

Influence negatively (%)
18.18

Neither (%)
7.27

More information on the fund's hiring and retention policies

Influence positively (%)
76.36

Influence negatively (%)
12.73

Neither (%)
10.91

Working with reputable global service providers

Influence positively (%)
80.00

Influence negatively (%)
14.55

Neither (%)
5.45

While GPs' anxiety is real, there's optimism, too. Despite macroeconomic and geopolitical challenges, most think the fundraising climate will improve in the next 24 months. For every asset class, far more expect it to get significantly better than significantly worse. Many respondents cited the need to hire and retain talent as a principal driver for future success. They're putting talent acquisition high on their list of priorities.

Maybe some of the optimism they express is wishful thinking. That level of hope was even more evident in 2022. To take private debt as an example, nearly 64% of GPs in this year's survey expect the fundraising environment to improve "significantly" or "slightly" over the next 24 months. In 2022 the figure was 69%. Slightly more expect it to stay the same or worsen in 2023, which is perhaps a reaction to persistent economic headwinds and geopolitical tensions.

Nevertheless, GPs appear firmly focused on growth, and dealing with the change it will bring. How they plan to manage that change is the focus of the rest of this paper.

Our experts



David Sarfas
Co-head, Fund Solutions, CSC



Venkataraghavan Srinivasan
Co-head, Fund Solutions, CSC



Anne Anquillare
Head of U.S. Fund Services, CSC



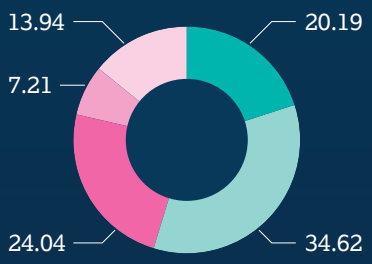
Marshall Saffer
Global Head of Fund Sales, CSC



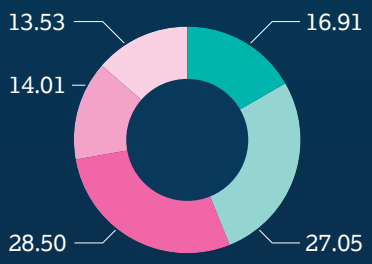
Drivers of change #1

DEMAND FOR DATA

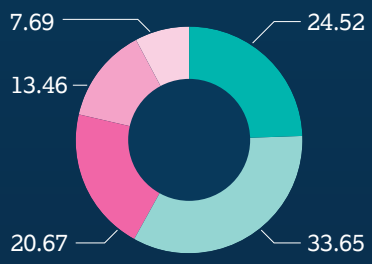
In the next three years, GPs are anticipating the following trends in LP demands for regular information about



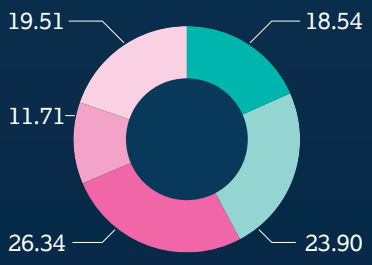
Portfolio performance (%)
(Including data on individual investments)



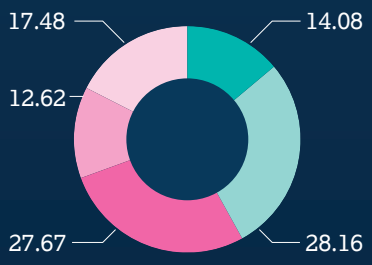
Operational SLAs (%)
(e.g., NAV deadlines or BoD meetings)



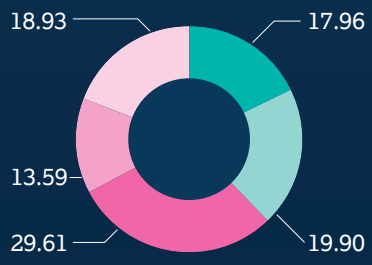
Cybersecurity (%)
(e.g., data breaches, IT policy)



ESG (%)



Diversity and Inclusion (%)



Forthcoming fund investment vehicles (%)

Live *Daily* *Weekly* *Monthly* *Quarterly*

Data drives the private capital industry. In our survey, around a fifth (20.1%) of GPs say they expect LPs to demand live portfolio performance updates in the next three years. This is a significant number, though it's considerably less than the 29% who answered similarly in 2022, and the 31% who did so in 2021.

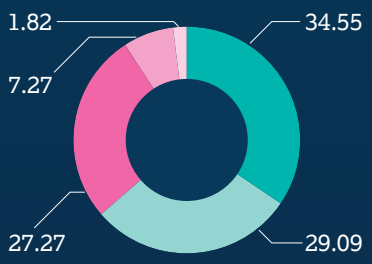
At the same time, the number who expect to have to give daily updates has increased from 28% in 2022 to 34.5% now. Whether you want live data or daily reports may simply be down to individual preference, though it may also depend on the kind of investments held by your fund. Hybrid funds and those that hold public equity may require more frequent valuation updates. What appears unquestionable is that the answers reflect a growing requirement for easy access to portfolio information.

Clearly, the trend is towards more frequent information in several areas. Over a third (34%) of GPs expect to have to offer daily portfolio performance data. A significant majority (58%) think demand for live or daily cybersecurity data will grow, while 17% think LPs will also be looking for live updates on operational service level agreements (SLAs).

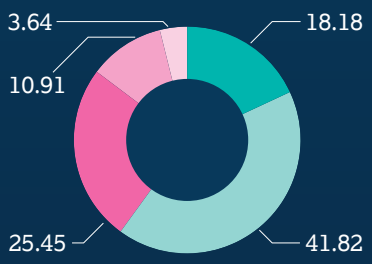
LPs are even keener on data. Nearly 35% of our LP respondents say they expect live information on portfolio performance in the next three years, suggesting that GPs are, if anything, underestimating the strength of feeling in this area. Over two-thirds (67%) want live or daily cybersecurity reports.

> *"The need for easy access is driving the requests for more frequent information in the slow-moving world of private capital. Investors want to be able access data when it's convenient for them. They don't want to search through emails for it or call the CFO. They want to self-serve."* Anne Anquillare, Head of U.S. Fund Services, CSC

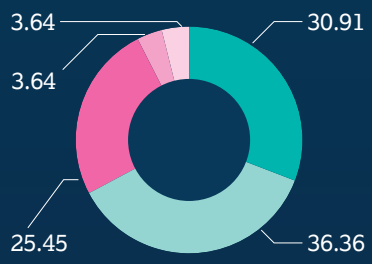
In the next three years, LPs will expect regular information on the following



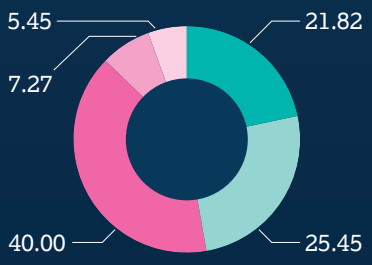
Portfolio performance (%)
(Including data on individual investments)



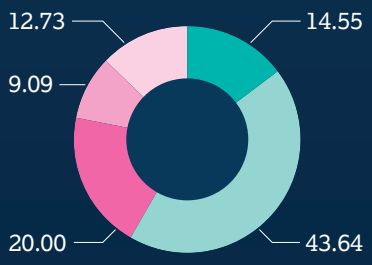
Operational SLAs (%)
(e.g., NAV deadlines or BoD meetings)



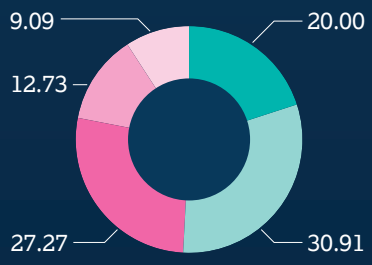
Cybersecurity (%)
(e.g., data breaches, IT policy)



ESG (%)



Diversity and Inclusion (%)



Forthcoming fund investment vehicles (%)

Live *Daily* *Weekly* *Monthly* *Quarterly*

The disconnect may reflect LPs' desire for data equality. Smaller investors want the same access to the data as larger players. Or maybe they're opening their smartphone banking apps and wondering why investment information can't be as readily available.

If one thing is clear, it's that the trend is only going one way. In open answers, GPs talk about the possibility of having to provide regular updates on everything from artificial intelligence (AI) to sustainability aspects in the not-too-distant future. This will only add to funds' operational burden, necessitating investment in staff and technology, or an expansion of outsourcing.

> *"With more and more investment in artificial intelligence and machine learning, LPs may need regular information to help them understand the latest technological progress and innovation."* Survey respondent

35%

The percentage of LPs who expect live portfolio performance information in the next three years



Drivers of change #2

EXPANSION AND DIVERSIFICATION

In which regions are you planning to expand?

GPs' own growth strategies are another driver of change. In a competitive market, nobody can afford to stand still. In our survey, 90% of GPs say they plan to expand geographical coverage either "significantly" or "somewhat" in the next 24 months. At the same time, nearly 97% say they will diversify into new asset classes.



Americas (%)
23.92

Asia Pacific (%)
17.56

Southern Europe (%)
15.01

Western and Northern Europe (%)
18.07

Central and Eastern Europe (%)
16.79

North Africa (%)
6.36

Sub-Saharan Africa (%)
2.29

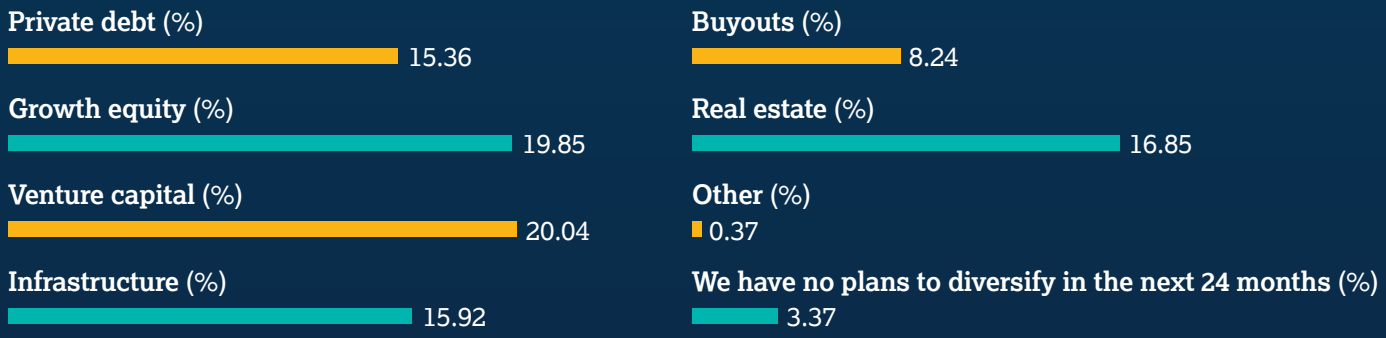
Funds are being proactive in the quest for the next great deal or for the next group of large investors.

The managers we surveyed globally are looking to the Americas (24%), Western and Northern Europe (18%), Asia Pacific (17.5%), and Central and Eastern Europe (17%) for new opportunities. Of U.S. managers, 46% are focused on expanding into Europe and 14% into Asia Pacific. The region continues to attract non-U.S. GPs, too, with 27% expecting to expand there.

> *"We are seeing significant interest in Asia Pacific. That's where you have a lot of opportunities in terms of undervalued assets. Those economies are also in a development cycle, which again creates opportunities for investors."*
> David Sarfas, Co-head, Fund Solutions, CSC

Which of the following are GPs planning to diversify into in the next 24 months?

GPs chase returns wherever they lead. That can mean moving out of their comfort zones when it comes to asset types. Our respondents are looking to move into venture capital, growth equity, real estate, infrastructure, and private debt in that order.



The results represent a slight change from last year when growth equity led the pack, and private debt was higher in popularity. Venture capital and infrastructure are two asset classes that have risen in popularity.

In general, diversification makes perfect sense, even if it involves unfamiliar territory. For example, private debt is a complex asset class, but plenty of GPs have already moved into it, or will do so soon because it provides returns stability not easily available elsewhere. Once you loan the money, you can expect regular and predictable interest payments. The only risk is of default.

GPs launch new strategies to attract investors. But it's a growth strategy that comes with a cost. A private equity fund focused on real estate can't successfully move into private debt without specialized knowledge around investment administration, due diligence, fund structuring, risk and liquidity management, investor relations, and regulatory and compliance demands, to name just a few.

It may need to employ new people and invest in asset-specific technology, or outsource these requirements and turn a fixed cost into a variable one while benefiting from a highly scalable resource.

The more strategies a GP moves into, the more these complexities escalate.

97%

The percentage of GPs expecting to move into new asset classes in the next two years

> *"If you invest in private equity, you're dependent on buying an asset and selling it. To that extent, your business is lumpy. Private debt is more likely to smooth your cash flows and, potentially, your revenue streams."*
>
> Marshall Saffer, Global Head of Fund Sales, CSC



THE CHALLENGES OF CHANGE

Everything we've looked at so far increases the administrative burden on fund CEOs, CFOs, CCOs, and COOs. New asset classes require new systems, processes, and specialisms. Investor demands dictate new ways of collecting, managing, analyzing, and presenting data. Geographical expansion exposes the firm to new regulations around compliance, local time zone coverage, operational requirements, and entity management.

GPs know that scalable growth means doing things differently. A large majority say they will expand their use of SPVs, hybrid, or interval funds as well as credit facilities over the next three years, tapping unexplored investor bases and asset classes. This reflects their ambitions and underscores the importance of agility and speed of action in a competitive environment. But they need people who understand these innovations, and the technology to operate them efficiently, either in-house or via a third-party provider.

Regulatory agencies' supervision of private equity funds is strengthening, so management needs to pay close attention to changes in regulations and make adjustments in a timely manner.
Survey respondent

Why use a credit facility?

Credit facilities give GPs access to borrowed funds, up to a predetermined limit. Here are four reasons to use them:

Liquidity management

Bridge the timing gap between capital calls and distributions.

Faster execution

Quickly capitalize on time-sensitive opportunities with immediate access to money.

Risk management

Draw on credit rather than being forced to sell assets cheaply at times of market volatility.

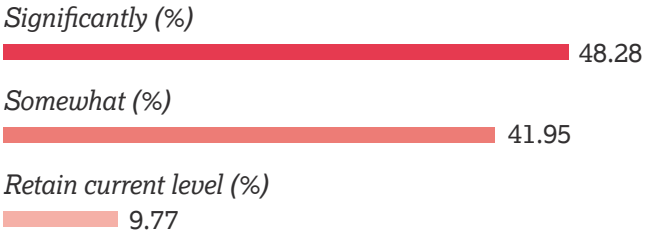
Enhance returns

Access capital at a lower cost than other sources of financing, such as equity or mezzanine debt, and use leverage to amplify investment capital and potentially increase investment returns.

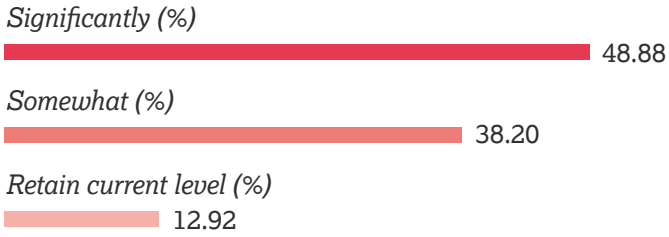
Credit streams, like other instruments of growth, also add to funds' administrative burden.

Over the next three years, GPs intend to expand their

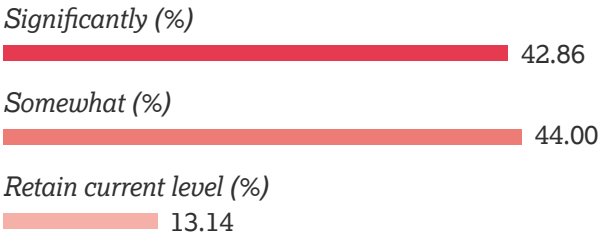
Use of SPVs



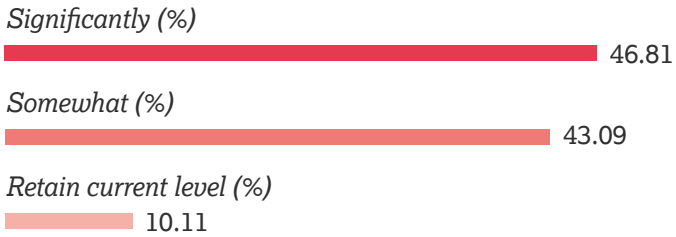
Use of fund credit facilities



Use of hybrid or interval funds



Geographic coverage



In the end, it all tightens the screw. SPVs need to be maintained in good legal standing. Hybrid funds require expert liquidity management. Credit facilities need to be administered.

With all of this going on, it's no surprise that nearly half (49.5%) of respondents place operations first or second when asked what would have the most impact on their day-to-day responsibilities, just behind portfolio performance. This is up by nearly 10% from last year. Out of 10 choices, these two plus regulation, investor demands, and cybersecurity make up the top five.

The growing impact of regulation

"In Europe, private funds are organized and run in accordance with the Alternative Investment Fund Management Directive (AIFMD). To U.S. managers looking to fundraise or deploy, AIFMD creates an overlay of scrutiny and cost that many aren't familiar with. But it's a tried and tested system, and it works. The regulatory framework is also continually evolving, ESG is an example, so local knowledge is key. And the upside is, much of this regulation is for investor protection. Regulatory scrutiny can add to a firm's workload, but it also reassures investors." David Sarfas, Co-head, Fund Solutions, CSC

"With the Securities and Exchange Commission (SEC) new Private Fund Adviser rules, there's even more risk associated with operations and reporting. Historically, when the SEC finds a bad actor, it will publicize those findings and that will give the entire industry a black eye. It will undermine trust across the sector. LPs have boards who will ask if they can trust this industry. So regulatory compliance is crucial, and at the same time becoming more challenging." Anne Anquillare, Head of U.S. Fund Services, CSC

Which of these do GPs expect to have the greatest impact on their day-to-day responsibilities?



These results may be an acknowledgment that operations and administration are no longer simply cost centers. In a world of tightening regulation, growing investor demands, and increased competition, they're differentiators and mitigate risks. Good funds separate themselves from the pack in the back and middle office.

It's important that they do. Trends in private capital, mirroring the earlier evolution of hedge funds, are towards rationalization or specialism. Managers survive and thrive by being good in every asset class or exceptional in one. The likely result is fewer, larger managers overall. In a consolidation cycle, forward-thinking GPs understand that success and survival are as dependent on operational excellence as they are on deal-making flair.

> *"Every firm in the market makes the case for why they're top quartile in terms of performance. So how do you make yourself stand out? You build trust through getting the basics right, like timely reporting, easy access to information, and a top-tier vendor ecosystem."*
> Anne Anquillare, Head of U.S. Fund Services, CSC



Managing change #1

THE MARCH OF TECHNOLOGY

If administration is becoming more burdensome as funds expand and diversify, what do GPs intend to do about it? In our survey, the most popular answer was to invest in technology. That was followed by expanding in-house teams, investing in distributed ledger functionality, and outsourcing more functions.

As the firm grows, GPs plan to do the following

Invest in expanding our technology framework (%)
25.45

Significantly expand in-house teams (%)
22.63

Invest in distributed ledger functionality (%)
16.77

Retain our existing balance between in-house and outsourcing (%)
16.36

Outsource more functions (%)
15.76

Not yet decided (%)
3.03

GPs clearly see technology as one way to square the circle of doing more with less in a highly cost-sensitive environment. Happily, LPs agree. When asked what they would like to see funds do, investing in expanding their technology framework was the most popular answer, with 25% choosing this option. When asked what would positively influence their opinion of fund GPs, the highest number (89%) said self-service functionality.

In an environment of cost-sensitivity and growing operational complexity, it's no surprise that a third of both GPs (32%) and LPs (34%) expect funds to maintain or grow their outsourcing model. While outsourcing provides a variable cost structure for operations, it's also an avenue for strengthening a fund's technology stack without breaking the bank.

LPs would like to see their fund C-suite executive change in these areas

Invest in expanding their technology framework (%)
25.00

Increase the size of their in-house teams (%)
22.62

Invest in distributed ledger functionality (%)
18.45

Infrastructure (%)
17.26

Managers and investors are on the same page. GPs' open answers reveal that many struggle to keep up with advances in technology and are worried about maintaining the quality of their technology stack. Added to that is the constant struggle to remain cyber-secure.

What technology will GPs invest in? There's considerable excitement, as might be expected, around the potential of AI, which is already being deployed in front offices to inform smarter investment decisions.

But in fund administration and operations, the answer is probably more prosaic. GPs of all sizes need systems that will collect, store, authenticate, integrate, and present data in a usable form, across asset classes. This includes specialized asset investment operations modules, and data warehousing that allows real time and bespoke reporting requirements with seamless integration of data flow. An excellent self-serve customer portal is also a crucial part of any modern fund technology stack. At the core of all this is the need for technology to connect disparate systems because unrestricted data flows are crucial to scalable operations.

> *"As GPs move into different asset classes it inevitably makes life more complex, because each asset has a different lifecycle, and each requires different underlying technologies. The complexity stems from having to integrate all these technologies and bring data together in a single reporting platform. That is a key challenge".* Venkat Srinivasan, Co-head, Fund Solutions, CSC



Managing change #2

THE TALENT CRUNCH

If funds want to expand into new territories and asset classes and service investors better, they need the specialist teams to do it. Technology alone isn't enough.

With that in mind, this year we asked specific questions around the recruitment and retention of talent. From the pandemic-fueled "great resignation" onwards, finding and keeping the right people has been an increasingly difficult task in many jurisdictions.

Our research findings bear that out. As we've seen, GPs and LPs both see technology as crucial to future development, but 44% of GP respondents place technology and reporting first when asked where they expect to have the biggest challenge in hiring talent. Adding to the issue, over half (51%) choose the same answer when asked about retaining talent and, with it, institutional knowledge.

> *"Our biggest challenge over the next three years will be cost management as well as talent acquisition and retention".*
> Survey respondent

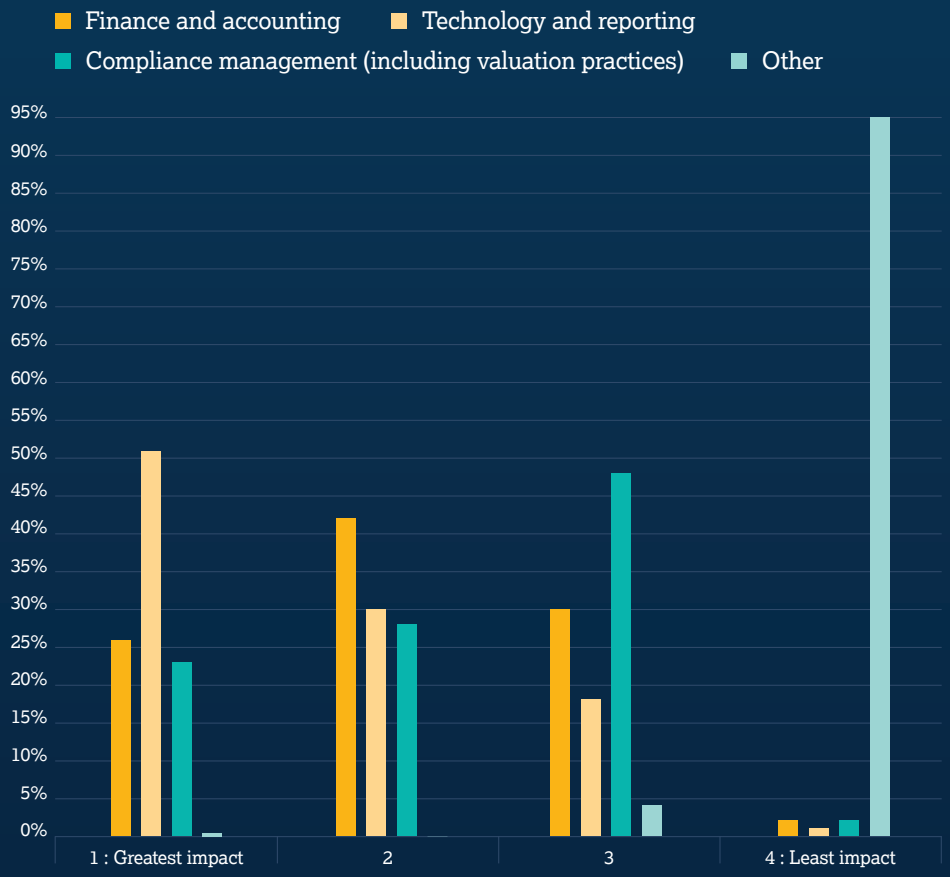
51%

of GPs think they will struggle to retain technology and reporting talent

The area of finance and accounting was the second most common answer to both questions about hiring and retaining talent, and this may be a long-term challenge for the industry. Colleges aren't producing the quantity of graduates that an expanding sector needs.

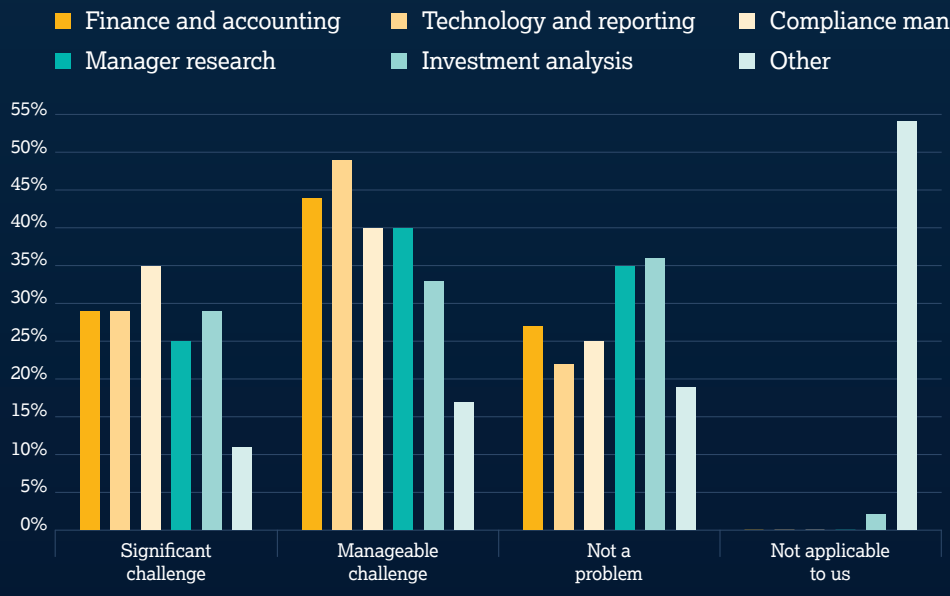


In which areas of existing expertise do GPs expect to have the greatest challenges in retaining talent and institutional knowledge?



"GPs need chartered financial accountants who understand asset types, and I think we're seeing a demographic shift where people just aren't going to school for that. If you look at some operations teams, the qualified staff are aging and the twenty- and thirty-somethings aren't coming through." Marshall Saffer, Global Head of Fund Sales, CSC

In the current market, the biggest challenge for LPs is hiring and retaining institutional expertise in these areas



When we asked LPs a similar question, the top result was compliance management, followed by technology and reporting as well as finance and accounting. This may reflect investors' growing focus on the risk of reputational damage. Whether family office or pension fund, nobody wants to end up on the news.



SQUARING CIRCLES AS FUNDS GROW

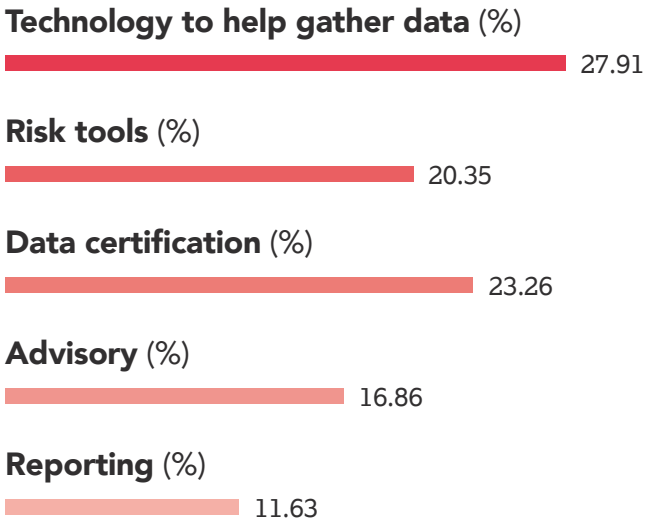
What conclusions can we draw from all this? Perhaps that the sector is in a period of flux. It knows where it wants to go but isn't yet certain of the best way to get there.

As a result, there are contradictions in our results. For example, when asked what firms plan to do as they grow, GPs see technology as one answer to the mounting pressure on time and resources. The second most popular answer to that question is to significantly expand in-house teams.

And yet, our recruitment and retention questions suggest firms are fully aware of the challenges they face in getting the talent they need. Ironically, they see the biggest challenge in recruiting people to manage and maintain all that gleaming new technology.

This is a tough circle to square, and outsourcing is one possible solution. Around 16% of GP respondents expect to go down this route, and slightly more LPs—nearly 17%—would like to see their GPs explore this option.

Which of the following would you like or expect your fund to outsource to an external service provider?



> *"The need to constantly invest in technology, and to keep up with the latest developments, is also one of the factors driving the shift to outsourcing and a one-stop-shop tech-enabled service provider".*
> Venkat Srinivasan, Co-head, Fund Solutions, CSC

The nature of outsourcing itself is changing, with the best outsourcing arrangements now akin to a partnership of mutual benefit.

When LPs were asked what they would like to see funds outsource, technology (in this case specifically to help gather data) again came out on top. In open answers, several LPs said they would consider outsourcing their own data collection, management, and reporting functions to a partner.

Outsourcing allows GPs to support multiple strategies across regions with a lean in-house operation. It allows for easy scalability of people and systems. It supports fund growth with a flexible, cost-effective operating model. In short, outsourcing takes major challenges around talent and technology and passes them to someone with specialist expertise in these areas.

Conclusion

CEOs, CFOs, CCOs, and COOs in the private market industry expect to expand into new asset classes and geographies and foresee growing fundraising activity across strategies. They predict growing investor demand for information (something confirmed by the LPs themselves), a tighter regulatory environment, and greater use of SPVs, hybrid funds, and credit facilities.

It all adds up to greater management and administrative burden. GPs are looking to a combination of technology and talent to ease the pressure.

At the same time, they understand that technology doesn't stand still, and talent is in short supply, making in-house operations more difficult. With that in mind, more are likely to consider outsourcing (or, increasingly, co-sourcing) to meet a growing need for scalable, specialized, and on-demand resources.



About CSC

CSC provides tailored administration and strategic outsourcing solutions to support the complex operations of alternative asset managers across jurisdictions and asset types while adhering to global regulations and compliance. A market leader, we work with funds of all sizes, from start-ups to the largest and most experienced fund managers in the world. Founded in 1899, CSC prides itself on being privately held and professionally managed for more than 120 years. We are the trusted partner of choice for more than 90% of the Fortune 500® and more than 70% of the PEI 300. CSC has office locations and capabilities in more than 140 jurisdictions across Europe, the Americas, Asia Pacific, and the Middle East. We are a global company capable of doing business wherever our clients are—and we accomplish that by employing experts in every business we serve. We are the business behind business®. Learn more at **cscgfm.com**.

cscgfm.com

251 Little Falls Drive, Wilmington DE 19808

Copyright ©2023 Corporation Service Company. All Rights Reserved.

GSM052423