KEYNOTE INTERVIEW

# Creativity amid adversity

*GPs are responding to a challenging market environment with ingenuity and innovation, say Deloitte's Emma Cox and Bryant Huber*

**Q GPs are facing a challenging fundraising environment. How are you seeing your clients respond?**

**Emma Cox:** It has been an extremely difficult time for many private equity firms, and for new entrants in particular. Against a backdrop of higher interest rates, we have seen a slowdown in exits driven by a dislocation between buyer and seller price expectations. This lack of distributions has impacted fundraising, meaning competition for LP allocations is high.

Despite this, many of our mega-fund clients in particular have been extremely successful in their fundraising, as LPs have consolidated with a smaller number of larger GPs – particularly those that have demonstrated above-average returns and can offer additional benefits in terms of improved reporting and increased co-investment opportunities.

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We believe these underlying dynamics, coupled with other factors such as succession challenges, will dramatically impact the shape of the industry.

**Bryant Huber:** GPs are responding to these challenges with creativity. In response to a lack of liquidity, we have seen a significant increase in the use of continuation vehicles; in response to a challenging fundraising environment, we have seen firms offering disruptive terms – for instance, offering LPs greater co-investment in transactions. GPs are also seeking access to new sources of capital, including private wealth investors.

In addition, some firms have acquired or created insurance companies to provide access to continuous long-term capital.

We are also seeing GPs expanding into new asset classes as they build AUM, including secondaries, private credit, infrastructure and real estate. For many firms, this cross-asset diversification is a critical strategy as the overall private capital industry continues to evolve. Finally, with multiple expansion in many industries remaining challenged, we are also seeing an increased focus on value creation plans.

**Q Are you seeing M&A at the GP level? What is driving those transactions?**

**EC:** M&A at the GP level is at an all-time high. It allows GPs to diversify into new strategies more quickly, enabling them to capture more LP capital at a time when those LPs are consolidating their relationships. Meanwhile, effective consolidation can result in operational and cost efficiencies: our data indicates that integrated firms generate 6-8 percent higher operating margins than non-integrated firms. Finally, I would point to succession. M&A can help facilitate leadership transition, enabling the retiring generation to unlock enterprise value in the process.

**BH:** Asset class diversification is certainly a key driver of M&A, alongside geographical expansion. Publicly listed firms have been most active due to their balance sheet liquidity; it will be interesting to see how privately held firms engage more fully in GP M&A activity.

## Q What key factors should be considered by GPs engaging in M&A?

**BH:** GPs engaged in firm-level M&A transactions face the choice of integration or structural and operational segregation. Integration can result in improved performance as both parties are able to leverage shared capabilities, access to finance and access to data, for example. However, the nature and pace of integration is critically important.

Potential challenges exist around the impact on talent and on the collective go-to-market approach. Firms need to carefully evaluate revenue and cost synergies against what is best for both organisations as they come together. It is critical to design and implement an appropriate new governance model that truly meshes the strategy, culture and talent at both investment management firms, as well as appropriate incentivisation and retention programmes for key talent.

**EC:** I would add that, where succession is the primary driver for M&A, there are additional factors to consider: firms must decide on the right price, payment terms and structure to appropriately reward the former owners while not disincentivising the next generation. That is hugely important for the longevity of the firm.

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>
> **EMMA COX**

## Q What are the key near-term opportunities for PE?

**EC:** In addition to opportunities related to consolidation and accessing new pools of capital, I would point to GPs' ability to leverage data, including through the use of AI, to enhance performance. We are increasingly seeing clients building in-house data teams. Those teams are using data to support investment decisions, drive value creation opportunities (including ESG), and enhance reporting. They are working hard to improve both the quantity and quality of data interrogation.

They are also increasingly implementing generative AI (in the origination phase) as a value creation lever within portfolio companies. This is a space that is moving extremely quickly, and I believe those firms that are focused on remaining ahead of the curve will reap the rewards.

**BH:** We are also seeing an increase in transaction activity, as interest rates have stabilised to a degree. We expect to see continued headwinds in 2024, but we certainly believe it will be a better year than 2023 in terms of deal volumes.

We recently surveyed more than 750 private equity dealmakers in the US and found that 86 percent expect to complete more deals over the next 12 months than they did in the past year. As such, our optimism appears to be matched by deal-doers themselves.

Furthermore, we expect to see an increase in complex transactions as GPs seek to drive differentiated value in their investments. That is leading to an uptick in carve-outs, joint ventures, business combination deals and cross-border transactions. These are more challenging deals to execute, certainly, but if done properly, they can drive tremendous value.

We are seeing GPs developing transformation plans for the assets they buy earlier and earlier in the process, recognising that differentiated returns will be driven by value creation during the holding period. They are also focusing closely on exit preparation, engaging firms like ours around sellside readiness and networking capital optimisation in order to drive favourable exit outcomes.

GPs have large numbers of companies in their portfolios today as a result of market dislocation, and so they are leveraging their advisers and scaling up internally in order to deal with an annual exit volume that is potentially going to be far higher than the historical norm.

Overall, I would say we are very bullish about the private equity industry, as it has demonstrated sustained and successful performance since its inception, as well as a willingness to adapt and innovate in response to change. There will certainly be more of that change to come, but everything points to the industry continuing to deliver outsized returns for investors, whatever comes their way. This is why we are so excited to stay close to our private equity clients, helping them drive value both at the firm level and within their portfolios. ■

Emma Cox is global private equity leader and Bryant Huber is US private equity leader at Deloitte