Investec

PRIVATE EQUITY TRENDS 2024

OUT OF THE ORDINARY

Summary and foreword

Welcome to Private Equity Trends 2024, Investec's 13th annual report on the state of the industry.

The report provides us with a unique opportunity to learn what general partners (GPs) think of key industry trends, including the challenge of higher interest rates and the increased focus on environmental, social and governance (ESG) considerations in investment decision-making.

We also explore more personal perspectives on issues such as career satisfaction and partner diversity.

For our survey, we polled close to 150 GPs at a time when the market has faced the stiffest headwinds in more than a decade. It is clear that GPs have accepted a new reality of higher interest rates, tighter liquidity and slower deal markets.

Our findings show that GPs expect returns and valuations to decline in the months ahead. Fundraising is set to take longer and deals are expected to become harder to source and close. There are no illusions about the challenges that lie ahead.

But while the industry has been gripped by the need for pragmatism, the private equity (PE) model remains as relevant as ever and is by no means broken. The market may not match the extraordinary deal volumes and fundraising observed at the top of the cycle in 2021, but transactions are still being done and GPs are still successfully closing their fundraising efforts. And if, as many expect, inflation continues to fall, and interest rates start to decline in major economies in 2024, the industry will be ready to capitalise on the many opportunities that will appear with enthusiasm (and plenty of 'dry powder').

When high-quality assets come to market, competition among bidders is as fierce as ever. Vendors are still achieving successful exits. Meanwhile, limited partners (LPs) continue to support the most trusted fund managers, as seen by a series of record fund closes in 2023, despite the prevailing macroeconomic challenges weighing on the market. This may be a tough time to be a GP, but opportunities continue to present themselves.

We hope that the research will prove as insightful for you as it has been for our PE team at Investec.

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Economic outlook

If 2022 and 2023 were the years of interest rate rises, 2024 looks to be the year of rate cuts, thanks to inflation that has receded steeply and looks poised to fall further. Yet, unless there is a sharp turn for the worse in the jobs market, the first steps to lower rates may be more cautious than markets are now pricing in. Still, a turn in the rate cycle should provide a stage for stronger growth, benefiting private equity.

In 2023, the global economy operated under the cloud of the ongoing war in Ukraine and, more recently, the Israel-Gaza conflict. Yet energy prices traded a long way below their peak. Along with higher interest rates starting to bite, this helped inflation to recede steeply, even if not yet to target. Pleasingly, this was achieved without deep economic downturns and sharp rises in unemployment.

Keeping interest rates steady could eventually push inflation too low. Hence, markets have shifted to factoring in rapid policy rate cuts in the major economies this year. Alongside this, longer-term bond yields have also slid, undoing some (but not all) of their previous rise.

Yet, unless unemployment surges, we expect central banks to proceed more cautiously this year than markets now envisage. We predict 75% of rate cuts in the US, the eurozone and the UK this year. We also caution that more of the burden of past interest rate rises is yet to filter through, likely keeping economic conditions subdued in early 2024.

Even so, a turn in the interest rate cycle should help set the stage for stronger economic growth momentum later in 2024, along with the direct boost to purchasing power from lower inflation itself. This mix of stronger growth and lower interest rates should provide a more constructive backdrop for private equity as the year progresses.

Industry outlook: an unforgiving landscape

46%

of participants said inflation had increased their borrowing costs and

25%

said it had eroded portfolio company margins.

The last 12 months have presented the industry with many challenges.

In the US[1] and Europe[2], interest rates have climbed to the highest levels seen in more than two decades, driving up deal financing costs and putting the brakes on transaction activity and fundraising.

According to Bain & Company's analysis, global buyout deal value declined 58% year-on-year over the first half of 2023 to $202bn[3].

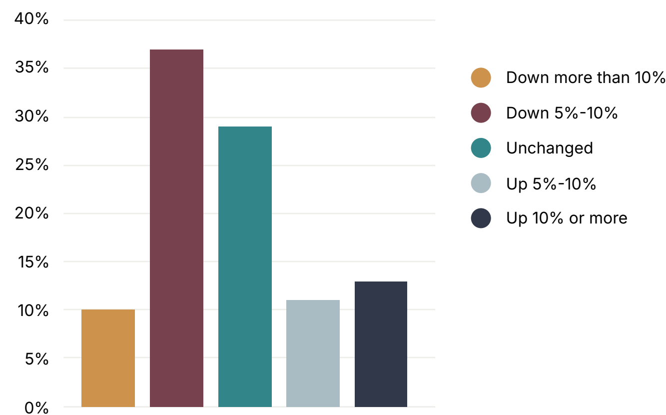
Although there have been some flagship fundraising exercises, overall private capital fundraising has dropped by more than a third (35%) year-on-year to $517bn[4].

The contrast with the 2021 bull market couldn't be starker. Yet the Investec Private Equity Trends 2024 report shows that the industry is under no illusions about the headwinds. PE professionals are rolling up their sleeves and taking a realistic approach until conditions improve.

> Just 19% of GPs said they see their next fund being 25% to 50% larger. This is half the level of the brighter days of 2022, when 46% predicted their next fund to be 25% to 50% larger.

Most people see returns unchanged or declining up to 10%

Q: Relative to 2022, how do you expect private equity returns (both at your firm and the industry generally) to perform in the next two years?



Return expectations for next 24 months relative to 2022, for both firm and industry

Our survey shows that 47% of respondents expect to see returns falling in the next 24 months, with only 24% optimistic that returns will track higher.

Higher inflation has been a key factor behind the recalibration of return expectations in the last 12 months, with survey participants citing increasing borrowing costs (46%), erosion of portfolio company margins (25%) and reduced exit opportunities (20%) as the main impacts of inflationary pressures on their firms. It's important to note that although inflation is predicted to moderate in most countries in 2024, few expect a return to the very low levels of the decade that started in 2010.

The industry is equally pragmatic when it comes to fundraising forecasts. There is also a growing acceptance that fundraising will take longer. Some 58% said they expected their next fund will take more than three months longer to close than its predecessor, with 27% expecting to take more than six months to reach a final close.

Greg Ciesielski, Managing Director at HarbourVest, says *the shift in market conditions will see a divide emerge in the market, where strong managers continue to raise funds and secure deals while others struggle.*

"It can be difficult to differentiate performance in a very buoyant environment, but when the market becomes more challenging, a bifurcation emerges because it becomes more apparent who the top-tier managers are."

> When there is a shakeout, quality is rewarded. In periods of market dislocation, investors cluster around the best managers, and those managers emerge stronger than before while others struggle.
>
> **Greg Ciesielski, Managing Director at HarbourVest.**

> If you're focused on businesses and sectors that you know and understand well and where you can deploy a real value creation plan, the opportunity is still very much there to drive the growth.

Pete Wilson, Partner at IK Partners

Back to normal

While the headline findings appear gloomy, it is important to place the results in context. The declining returns and fundraising expectations are relative to the unique environment of 2021 when rock-bottom interest rates and the easing of Covid-19 pandemic restrictions fuelled an explosion of optimism. Deal flow and fund closes may be down on the exceptional levels observed in 2021, but still compare favourably with pre-pandemic levels and should be seen as a normalisation of the PE space rather than a signal of a broken market. In its 2024 Global Report, Preqin predicts that private equity assets under management (AUM) will still grow at a creditable annualised rate of just over 10% up to 2028.

Indeed, despite expectations of reduced returns, 92% of respondents still expect to see their current funds clear the minimum return hurdle rates to make carried interest payouts.

This finding could be read as reflecting an optimism bias among the GP community, but it is worth noting that the predictions in our previous survey were generally quite accurate (see *Valuations and the new reality* later in this report). GPs recognise that market conditions have changed but are adapting accordingly and have down-to-earth expectations of delivering steady returns for investors through the cycle, albeit below the blockbuster levels achieved in the bull market of 2021.

Pete Wilson, Partner at IK Partners, says: *"A tougher macroeconomic backdrop, inflation and higher interest rates could make it harder to generate strong returns.*

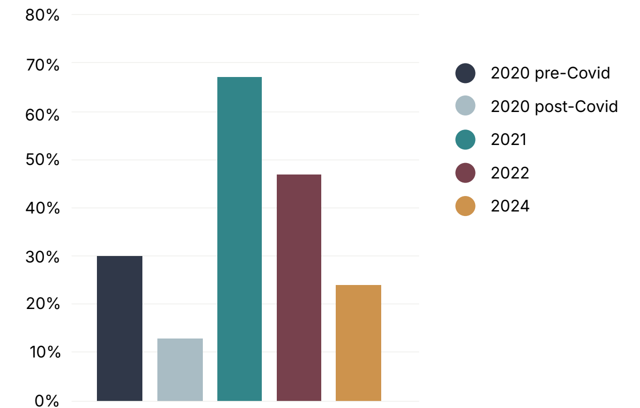
"But if you're focused on businesses and sectors that you know and understand well and where you can deploy a real value creation plan, the opportunity is still very much there to drive the growth."

Our survey also shows that a divergence in returns expectations is emerging between large funds, which we define as funds with assets under management of more than $10bn, mid-sized funds (AUM $1bn to $10bn), and smaller funds (AUM less than $1bn).

For large- and mid-sized funds, those who expect returns to fall in the next two years clearly outnumber those who expect returns to rise. But it is smaller funds where the gloom is most intense: just 12% expect an increase against the 56% expecting a fall.

The proportion expecting returns to increase has fallen back to 2020 levels

Q: Percentage in each year expecting returns to rise in the next 24 months.



Percentage in each year expecting returns to rise in the next 24 months

19%

expect their next fund to be smaller. In our last study only

2%

expected their next fund to be smaller.

LPs pivot to larger funds

The greater optimism among managers with bigger funds reflects the longer-term trend of investors allocating more capital to bigger private capital platforms.

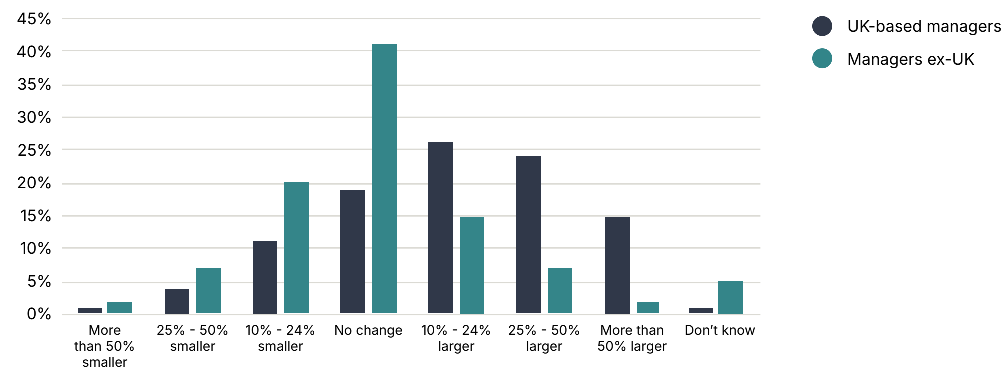
As PE AUM has grown – increasing 4.3x between 2010 and 2022 to $7.6trn according to Preqin figures quoted by S&P[5] – investors have pivoted towards larger fund managers that can manage and deploy larger allocations. McKinsey & Company's Global Private Markets Review 2023 reported that this was accelerated by the tougher environment. Amid a pullback in commitments, it said, new and smaller funds are seeing reduced backing[6].

Yet large fund managers have continued to reach bumper fund closes, with investors holding back what capital they have to deploy for large funds that offer a bigger buffer against downside risk. CVC Capital Partners, for example, closed the largest private equity fund on record in July 2023, securing €26bn from investors[7]. TA Associates (which raised $16.5bn)[8], Permira (€16.7bn)[9] and Warburg Pincus ($17.3bn) are among the other mega managers to have closed new funds in 2023[10].

GPs at smaller managers are optimistic that their next funds will be larger. This was true of 59% of those with less than $1bn, against 41% of those with $10bn or more under management. The key difference is that for GPs at larger funds, fundraising is reality; for those at smaller firms, it's still just a plan.

UK-based managers are more optimistic their next fund will be larger

Q: How do you think the size of your next fund will compare to its predecessor?



Valuations and the new reality

The days of delivering PE returns on the back of rising asset prices appear to be over.

According to the Argos Index, which tracks the earnings before interest, taxes, depreciation and amortisation (EBITDA) multiples paid for mid-market deals (€15m to €500m) in Europe, asset prices have corrected. Average EBITDA multiples came in at 9.1x in the third quarter of 2023, 2.5x lower than the levels observed at the peak of the market in in the second quarter of 2021[11]. They are also below the five-year average of 10.2x.

Pete Wilson, partner at IK Partners, says: *"The days where PE could buy a business at a low price, do very little and sell it at a high price, are long gone. For me, the key is to be really precise on the value creation plan and be thoughtful upfront around who your buyers will be down the line.*

"Focus on those fundamentals and you are then not reliant on a strong or a soft exit market."

> "The days where PE could buy a business at a low price, do very little and sell it at a high price, are long gone."
>
> **Pete Wilson, partner at IK Partners**

Our survey findings show that managers are adjusting to this new reality and that the outlook for the next 12 months remains sombre. Some 58% of respondents expect to see valuations drop in the year ahead.

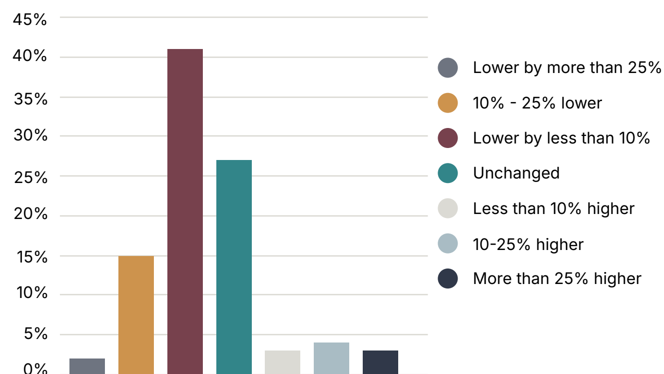
The cautious approach to asset valuations counters criticisms that PE firms did not mark down portfolio company valuations in line with the decline in public markets when interest rates and inflation first gripped markets[12].

Prudent valuations

This year's poll shows that GP valuation forecasts made a year ago were pretty accurate. Most people expected valuations to decline by about 10%: in reality, most saw valuations decline by about 5%.

Most people see deal valuations in the next 12 months unchanged or falling as much as 10%

Q: How do you think deal valuations will move during the next 12 months?



Excludes 4% who said they don't know

Other studies also show that GPs take a conservative and cautious approach to valuing portfolio companies. Burgiss data, for instance, shows that between 2012 and the third quarter of 2022, 70% of buyout exits proceeded at a higher price than the target company's previous valuation[13].

There is also a sense in the market that although valuations overall are seen moving lower, pricing is split, with a sharp line between a select group of high-quality assets and others.

Livingbridge Partner Daniel Smith, says*: "Managers still have substantial 'dry powder' to deploy, so for the best businesses there is still intense competition. For a high-quality company, managers can still build the right value strategy to get to a '2021 price', even if there's a bit less debt and it's a bit more expensive."*

61%

say valuations fell in the last 12 months, against

13%

who experienced an increase.

Deployment and dry powder

Private equity managers still have vast pools of 'dry powder' available to invest — some $1.25tn, according to Preqin's most recent estimate.[14]

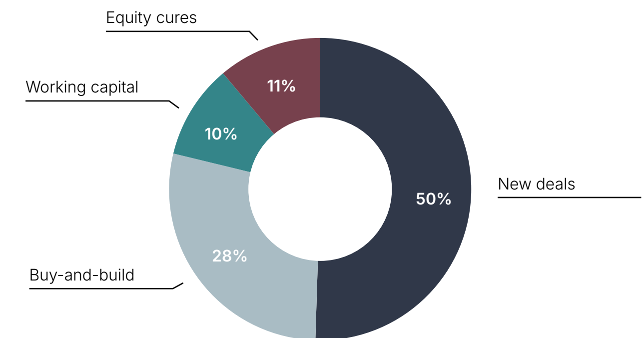
The challenge for GPs in the current market is to invest these large pools of capital at a time in the cycle when deal volumes have tailed off and it is harder to get money out the door and into good companies.

However, the survey findings indicate that GPs have continued to put money to work, with deployment remaining mostly unchanged. The long-term picture, though, is one of deceleration. In our previous survey, around 41% of participants said they had managed to increase deployment by 10-25%. This year the figure was just 16%.

A contributing factor to the slow pace of deals is a reluctance from vendors of companies or other assets to test the market at a time of uncertainty. No-one wants the experience of a failed auction.

Just half say new deals are first choice for capital deployment

Q: How have you deployed the majority of your capital during the last 12 months? Please rank from highest deployment to lowest deployment.



Shows respondents' first choice for capital deployment in the last 12 months

> Private equity experienced a period where there was an acceleration in deployment. There has been a reset back to more normalised levels of deployment, but this isn't 2009 when everything ground to a halt. The market is still functioning.
>
> **Greg Ciesielski, Managing Director, HarbourVest**

Toolkit of investment options

HarbourVest Managing Director Greg Ciesielski, says it is important to see slowing deployment in the context of above-average deal activity in prior years. Deals are still getting done, if not at the same rate as 2021 and early 2022.

Nevertheless, sourcing new deals has become more challenging and GPs are exploring all avenues available to drive deal flow. Our survey showed that while new deals remain the number one priority for deploying capital for 50% of respondents, the other half listed maintenance and enhancing the value of existing portfolios as the number one priority for capital deployment.

> Despite the tough environment 45% expect to look at more public-to-private opportunities in the next 12 months

Dealmakers also continue to see public-to-private (P2P) deals providing a steady flow of investment opportunities. Even though stock markets rallied at the end of 2022 and into 2023, 'take-privates' have accounted for a significant chunk of private equity deal activity, with analysis from EY showing that take-privates represented 42% of private equity deals in the second quarter of 2023[15].

Almost half (45%) of respondents said they expected to look at more P2P opportunities during the next 12 months, although the scope for P2P investment appears to be limited for smaller managers, with just 29% of firms with funds of less than $1bn seeing more P2P opportunities versus 50% with funds in the $1bn-$10bn range.

The mix of deployment pathways reflected in the findings highlights the value to GPs of having a toolkit of investment options that enables them to broaden and deepen their deal pipelines.

Philip Edmans, Partner at Inflexion Private Equity, says: *"When deal volumes do contract, the assets that do trade are of very high quality and are highly competed for. Maintaining deployment in these situations means that you have to have angles to win and that includes having a broad value acceleration toolkit to develop an effective investment thesis.*

"You have to have multiple levers for creating value through your hold period – developing new products, margin expansion, digitalisation and geographic expansion. The more value creation tools you have, the more optionality you have. That becomes more and more important in an uncertain environment."

The importance of exits

The pressure to get deployment moving again will be essential for the long-term viability of a manager's franchise. This urgency is matched when it comes to exiting assets. According to Bain & Company, buyout funds alone have a record $2.8trn of unexited assets sitting in portfolios – more than four times the figure during the 2008 financial crisis[16].

The exit backlog is the main reason for reduced fundraising, as LPs are waiting to receive distributions back from managers before ploughing capital back into a new vintage of funds.

Our survey findings show that a growing cohort of managers will have to come back to market with new funds in the near term.

Some 44% of respondents said they had less than 25% of dry powder available in their current funds, the traditional trigger point for launching new fundraising.

> The secondaries market is set to play a crucial role in restructuring the funds of managers that will struggle to raise new funds. If you look back to the period following the 2008 financial crisis, secondaries players stepped up to recapitalise and restructure funds, and provide LPs with liquidity.
>
> **Matt Jones, Co-managing Partner of US and European Secondaries at TPG**

The PE secondaries market is expected to play a critical role for GPs and LPs as the fundraising wall comes into view.

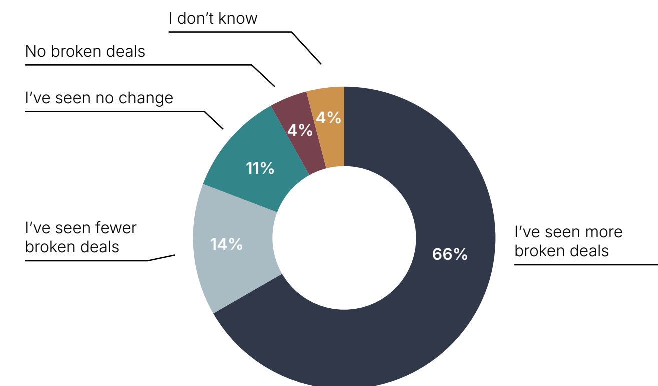
Indeed, GP-led secondaries and continuation fund deals have already emerged as a credible alternative exit route for the right assets at a time when other exit channels are constrained.

Matt Jones, Co-managing Partner of US and European Secondaries at TPG, says: *"Given that IPO markets have been shut and M&A bids weak, more and more general partners have contemplated whether or not a continuation vehicle may be the right way to return distributions to LPs from certain assets within their portfolios.*

"Where a continuation fund is most relevant is where GPs have very good companies that they don't want to relinquish control of, certainly not in the valuation environment we see today, but are under pressure to generate distributions for their LPs. A continuation vehicle can prove a very elegant solution in that scenario."

Failed auctions have become common

Q: Have you observed failed auction processes during the last 12 months?



Shows broken deals respondents have personally observed in the last 12 months

GP commitment in numbers

GPs have been upping their commitments to new funds through the recent market dislocation, aiming to demonstrate that their interests are aligned with those of their LPs[17].

Our survey found that the typical GP commitment averaged around 3%, with the threshold broadly the same across funds of different sizes and in different locations.

Even though fundraising markets have cooled, and GPs are less likely to have to fund commitments to new vehicles that are multiples larger than their predecessors, funding a GP commitment has become more complex.

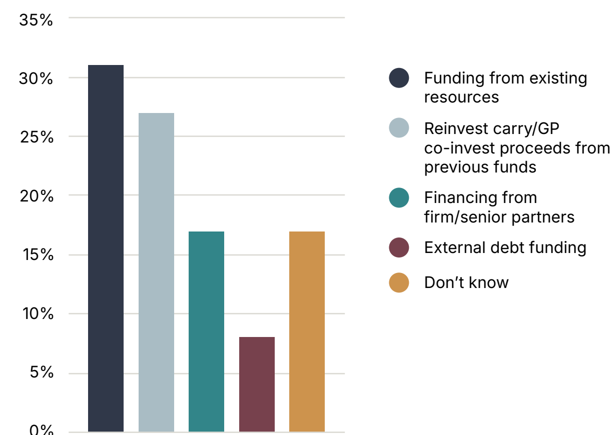
Interest rates have raised the costs of external debt funding for GP commitments. While almost all GP respondents expect to make carried interest, there is less visibility on the size of carry pots and how much carried interest can be set aside to fund future GP commitments.

The impact on individuals is not to be underestimated, as GPs must still fund sizeable personal commitments to new funds when borrowing costs are higher and carry payouts unpredictable. LPs want to see strong alignment and meaningful manager commitments in a tough market, even though securing this capital has become harder.

It comes as no surprise that a broad range of options are being explored when it comes to funding the next GP commitment.

Higher interest rates may be why external debt is becoming less favoured. Last year, it was the number three choice for funding GP commitments; this year, it was ranked fourth.

How are you financing your GP commitment?



31%
of survey respondents chose funding from exiting resources as their number one choice

27%
chose to carry reinvestment/GP co-invest proceeds from previous funds

17%
chose to finance from the firm/senior partners

8%
chose to finance using external debt funding.

Five things that have changed in the lending market

1 Banks are back

54%

said senior bank debt/term loan A finance was their most-used financing in the last 12 months

What's behind this revival of senior debt and loans raised by way of a bank club? One reason is that high street lenders can provide fewer turns of leverage at lower margins. This option has played well with some GPs, as rising interest rates make the overall cost of debt a key concern to already-challenged corporates.

***Inflexion Private Equity Partner Philip Edmans, says**: "Banks have become even more relevant. The higher cost of debt has led to lower leverage, and when leverage multiples are lower, banks can just price more competitively than funds. Clearly credit funds offer other benefits, such as ticket size and flexibility."*

"But for the less complex or smaller holds at lower leverage levels, we do see the banks being quite active."

Still, unitranche (a blend of senior and junior tranches of debt) remains a key option in the capital mix, with 29% of respondents ranking it as their number one option. In terms of size, smaller funds in particular continue to use unitranche frequently.

Asset-backed lending, meanwhile, ranked as a popular alternative option. It is most used by just 5%, likely due to it being suited only for asset-rich borrowers. However, 48% had it as their number two or number three most-used source of borrowing given the significant cost benefits it presents.

> "Banks have become even more relevant. The higher cost of debt has led to lower leverage, and when leverage multiples are lower, banks can just price more competitively than funds."
>
> **Philip Edmans, Private Equity Partner, Inflexion**

2 Fewer lenders are chasing business

56%

said fewer lenders are active versus a year ago

Pete Wilson, partner at IK Partners, says however, that while lenders are not lending at the same pace as in earlier years, there is still an appetite to finance deals that land in the lender's sweet spot.

"Sourcing debt is harder but if you understand how lenders think, what they like, what they don't like, and invest the time to guide lenders through a process, debt is absolutely still available, he says. *GPs with in-house capital markets teams that understand lenders are really benefiting from that resource now. It is a key point of differentiation."*

3 Terms are tougher

87%

have seen more covenants or tighter terms on financing

In a choppier market, cautious lenders are also asking for more from borrowers when negotiating terms (including covenants, documentary controls and rates) on financing, according to our survey findings.

Livingbridge Partner Daniel Smith notes that lenders are looking at each transaction on its merits. He says that securing the best terms is a function of matching the right credit with the right lender.

"The level of appetite is on a deal-by-deal basis," he says. *"Sometimes you have to search for the lender for whom that particular deal is right, and that's a very different environment to 2021."*

4 Multiples are squeezed

45%

have seen an EBITDA reduction greater than 1x

Supply and demand dynamics are both at play when it comes to lower leverage multiples. Lenders have been reluctant to provide capital structures that are heavily leveraged and there is also restraint from borrowers, who are looking carefully at transaction structures and scaling back on leverage when deemed necessary.

Edmans says. *"The cost of capital has increased and that flows through to leveragability, but that doesn't mean that lenders aren't open for business.* Any potential reduction in availability is down to lenders, quite sensibly, saying that a business can't service higher levels of debt in the current rate environment. That is not a contraction in supply."

5 Most people have limited hedges. Is it time to increase?

58%

said less than a quarter of their portfolio is hedged

In the low interest rate environment in the years prior to 2022, hedging interest rate financing costs was little more than an afterthought for most managers.

However, after consecutive rate rises, the rates environment has dramatically changed. Whilst markets are pricing in that these have peaked, there is a lot of uncertainty around the timing of interest rate cuts worldwide in 2024. Data dependency will remain a key point throughout the year, as well as growing signs of further geopolitical risk and potential impact on supply chains.

"There is certainly more focus on hedging from the market than there was previously. The rates firms will hedge to will be higher, but private equity can, and has, operated in a higher rate environment before and been successful," **Edmans adds.**

Solving the puzzle of career satisfaction

92%

expect their current fund to make carry.

Our research shows that career satisfaction has been hit hard during the last year, mirroring the impacts on returns and valuation expectations.

Only 29% said they were more satisfied with their careers than 12 months ago, with 49% unchanged and more than a fifth unsatisfied.

The differences with results from our previous surveys are glaring. A year ago, 45% of respondents were increasingly satisfied with their careers; the year before that, those increasingly satisfied with their careers made up half the respondents.

Yet it would be a mistake to read the dip in career satisfaction reported in this year's survey as simply a function of sliding returns – after all, almost all respondents still expect to make carried interest.

A closer reading of the data shows key factors behind career satisfaction. One was the level of dry powder: compared to the 29% figure for all respondents, increasing career satisfaction was reported by 44% of GPs whose current fund still has between 25% and 50% of dry powder to deploy. Those with less or more dry powder had lower career satisfaction scores.

This 'Goldilocks zone' for dry powder suggests that the ideal position for GPs is to have closed some deals in the testing markets of the last 18 months but to also have sufficient capital available to provide space and time before facing a fundraising.

The lower career satisfaction for GPs with a lot of dry powder suggests that although free from fundraising pressure, they are concerned about pressure to deploy.

"Slowing deployment can pose some risk if too severe. If a firm's ability to deploy is seriously hampered, risks around talent retention and future fundraising do come into view."

Greg Ciesielski, Managing Director, HarbourVest

29%

are more satisfied with their career than 12 months ago, but this rises to

35%

if they think their next fund will be larger

44%

if they have 25%-50% dry powder and

34%

for those who believe ESG adds value to a portfolio.

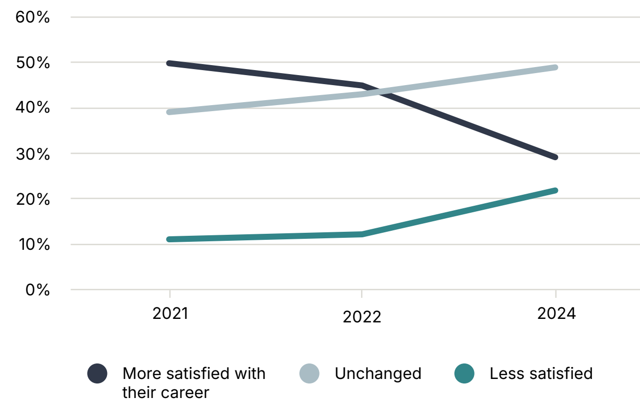
Greater expectations

Another key factor driving career satisfaction was expectations of next fund size: compared to the 29% figure for all respondents, increasing career satisfaction was reported by 35% of GPs who expected their next funds to be larger. This shows the appeal of firms that are growing and offer people a long-term runway for career progression and development. There is an existential element to this finding, too – the long-term career prospects at a firm that is at any risk of not raising a new fund, or paring back fund size, are likely to be limited.

Livingbridge Partner Daniel Smith, says: *"We want to create and nurture a team environment where outstanding people can realise their full potential, and that isn't simply determined by financial reward. Talented people are looking for opportunities to stretch themselves and grow and we are very focused on giving our teams the space and autonomy to do that."*

Career satisfaction has taken a hit

Q: How satisfied are you with your career compared to 12 months ago?



Respondents rated career satisfaction now versus 12 months ago

The survey also finds that career satisfaction rises to 34% among respondents who believe ESG adds value at a portfolio level, providing further evidence that the drivers of career satisfaction are more nuanced and extend beyond simply making money.

Pete Wilson, Partner at IK Partners, says: *"Private equity offers the opportunity for employees to meet with management teams of really interesting, diverse businesses every day and to partner with those businesses to drive transformational change."*

Getting well paid, but not enjoying that richness of experience, only goes so far. *"The experience of working on new deals, partnering with strong and ambitious management teams and participating on portfolio company boards is a huge part of what people are looking for." he says.*

Ciesielski adds that candidates entering the PE industry are in it for the long haul, across the ups and downs of the market cycle.

"This is an apprenticeship industry that people come into to build a long-term career. I can't see candidates quitting private equity just because the industry is navigating short-term headwinds," he says.

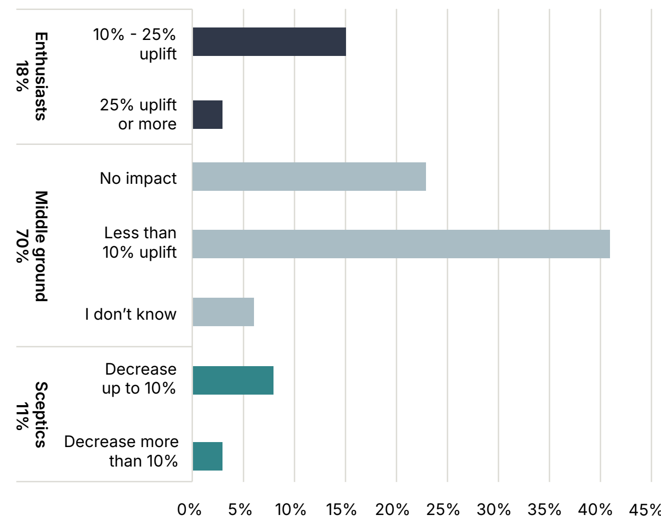
ESG: An unstoppable force?

This year's survey findings underscore how environmental, social and governance (ESG) considerations have moved firmly into the PE mainstream and become a driver of value in addition to an exercise in best practice compliance.

A majority of respondents (59%) said the implementation of ESG best practice at portfolio company level adds to value. However, most thought the impact was modest; 41% said the uplift was less than 10%. Only a small minority (11%) said ESG implementation decreased company value and 29% said it had no impact or they didn't know.

Does ESG add value at the company level?

Q: In your view, does the implementation of ESG best practices at portfolio company level add to its value?



The finding also showed how ESG has increasingly become 'table stakes' in deal processes, serving as both a spur to pursue a deal and a negative screen where deals are declined because of ESG risk.

More than 80% of respondents said that the influence of ESG on the decision to invest in a company, or not to invest in a company, had either increased or stayed the same. Only 17% said ESG had not been a significant factor in investment decisions.

> ESG is a key focus area. Not only is it the right thing to do, it makes good business sense and we have seen examples in our own portfolio where buyers have been attracted to, in part, a company because of its ESG credentials, and that ESG angle has added value at exit.

Philip Edmans, Private Equity Partner, Inflexion

Mutually beneficial results

Our survey results echo the conclusions reached in other research connecting strength in ESG with superior commercial performance.

These include a recent Investec study into UK mid-market firms in which 65% of PE-backed companies said strong ESG performance makes them more attractive to potential partners and acquirers[18].

ESG and financial returns are increasingly seen as mutually reinforcing.

> "I sense that it will become increasingly the case that certain buyers and investors will not be interested in businesses without solid ESG credentials. That can feed into valuation on exit simply because with good ESG in place, you will be attracting a bigger pool of possible buyers for a business."

Daniel Smith, Partner, Livingbridge

Given the strong momentum behind ESG that came through in the findings, it was surprising to see that 56% of respondents said some investors are too focused on ESG.

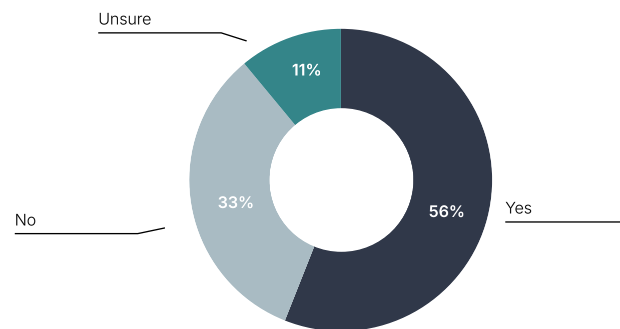
In some jurisdictions, such as the US, there has been a political pushback against asset managers using ESG filters to screen investments, with ESG sceptics arguing that it is distracting from maximising returns[19].

However, there is a sense that the findings in our survey are more reflective of frustrations with myriad ESG reporting frameworks and standards, rather than ESG in principle.

HarbourVest Managing Director Greg Ciesielski says: *"Industry convergence around ESG reporting and standards is an important next step. Frustration can emerge when managers are asked for different data by investors and aren't clear on why it is being requested and what it is used for,".*

Are some investors too focused on ESG?

Q. Do you feel that some investors are too focused on ESG (at the expense of commercial performance)?



Question did not ask respondents to specify how many investors

Progress on diversity... but a way to go

In addition to making ESG a priority at portfolio company level, GPs are also looking at their own organisations, with diversity in the PE workplace high on the agenda.

Daniel Smith, Partner, Livingbridge says: *"The industry as a whole is still at a relatively early stage when it comes to addressing diversity. There are really good initiatives that have been launched to address this, and there is progress being made, but it's relatively early days. From Livingbridge's perspective, at a senior level and partner level and the management board, we are a very diverse firm. We work at it, and we see the benefits as an organisation."*

Of course, responses on hiring may become less reliable over time: some firms will have growing cohorts of female and ethnic minority partners so later hires may be less noticeable as diverse management teams become the norm. Still, there is work for PE to do when it comes to diversity.

Ciesielski is optimistic that measures introduced to improve diversity in recent years will deliver results.

"Private equity has made progress on diversity. There is more to do, but firms are taking this very seriously. We see managers setting up graduate training programmes rather than just relying on recruitment from investment banks, and initiatives like Level 20 and the 10,000 Interns Foundation are having an impact," he says. *"This is an apprenticeship industry, so it does take time for talent to develop, but the work done now is laying the foundation for a more diverse industry in the future."*

44%

of participants said their firm has appointed a female or ethnic minority partner in the last year, but only

27%

of GPs with AUM below $1bn.

"The industry as a whole is still at a relatively early stage when it comes to addressing diversity. There are really good initiatives that have been launched to address this, and there is progress being made, but it's relatively early days."

Daniel Smith, Partner, Livingbridge

...and finally, tax

Every time a general election looms, a debate starts on taxation of carried interest.

With 2024 likely to be a general election year, carried interest has been in the spotlight once again, with reports that the Labour Party is considering proposals to tax carry as income. This would tax carry at the top earners' rate of 45%, as opposed to its current tax treatment as a capital gain, which is taxed at a lower rate of 28%[20].

Our survey indicates that while GPs are monitoring developments around the potential tax treatment of carried interest, any change would not spell doom for the UK's status as a major global centre for the industry.

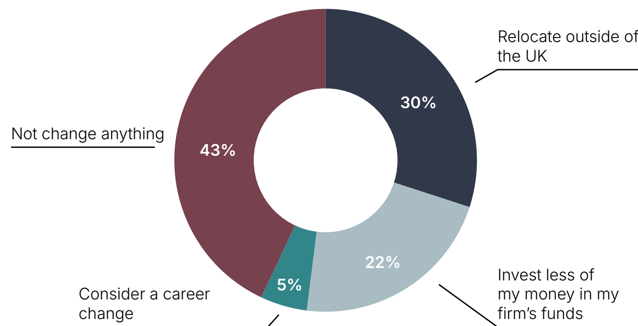
Some 43% of the respondents with UK-based funds said they would not change anything if the tax on carry was increased, although 22% said they would invest less in their firm's funds. Less than a third (30%) of respondents signalled that they would relocate outside of the UK, while 5% said they would change careers.

The findings make for an interesting comparison with a similar question included in the Investec GP Trends 2021 Report, where 46% of respondents agreed that if carried interest were to be taxed as income, rather than capital gains, they would change tax residency.

This year's survey indicates that GPs are taking a moderate view of tax changes. Still, the stakes are high: law firm Macfarlanes forecast that if tax increases meant that just 150 of the UK's best-paid private equity executives relocated to another country, the government's tax haul would be reduced[21].

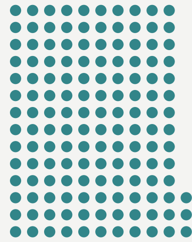
What would you do if the tax on carried interest was increased?

Q: If taxation on carried interest in the UK was increased, what action would you take?



Data shows responses from UK-based GPs

About the survey



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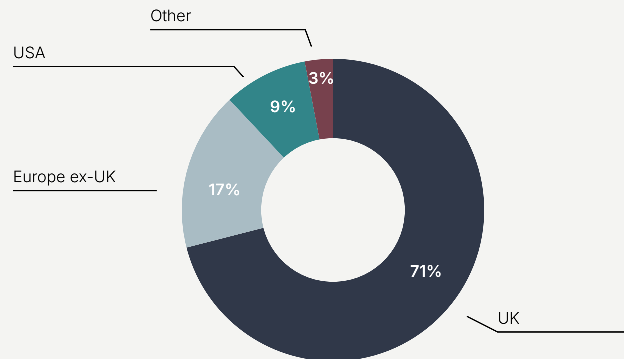
respondents, conducted online in September and October, 2023

22%

Female

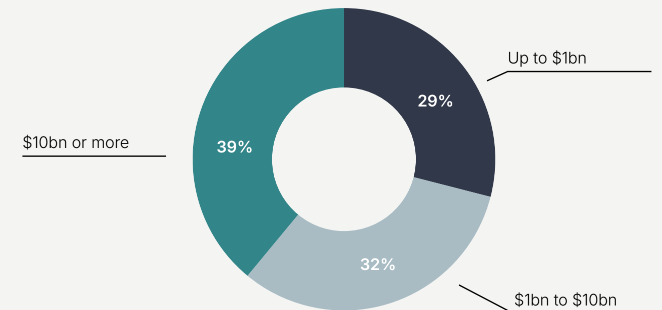
Where are they based?

Q. Where is your normal place of work?



Assets managed

Q. What is your organisation's total assets under management?



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