Why private equity limited partnerships are turning to specialist outsourced support

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As the private equity sector continues to evolve, so do the expectations of fund managers and their investors.

Regulatory complexity, fast-paced technological advancement, and a reduction in operational fees for a competitive edge, are all contributing in the shift towards outsourcing. Increasing demands and expectations from limited partners has led to more private equity firms sub-contracting specialist support to meet clients' needs while ensuring regulatory and reporting compliance.

By outsourcing certain functions, private equity firms can acquire specialised expertise and generate cost-effective solutions. It also frees them up to focus on their core competencies. However, outsourcing is more than simply a strategic cost-saving measure or a way to leverage external talent for additional support – it's a strategic advantage for private equity firms seeking to power growth and scale upwards.

Let's dive a little deeper into the trends driving this demand.

Increases investor confidence

The regulatory environment of the global private equity market is expected to become even more complex this year, and into 2024.

Private equity funds have seen changing rules in anti-money laundering (AML), know your customer (KYC) objectives, ESG, and economic substance, as well as modifications to the Organisation for Economic Cooperation and Development's (OECD) common reporting standards (CRS). Last year, the Securities and Exchange Commission (SEC) also adopted a new set of rules that significantly expand the regulatory compliance requirements for private fund administers.

Compliance with these regulations requires private equity firms to maintain robust internal controls, perform regular audits, and submit accurate and timely reports. In an ever-evolving regulatory landscape, the use of an independent, third-party specialist is a comfort to limited partners that the fund is being managed effectively.

Outsourcing certain functions, such as compliance and financial reporting to specialist providers can help private equity firms navigate regulatory demands more effectively. Specialist providers have a deep understanding of regulatory requirements and can ensure the necessary processes and controls are in place to meet compliance obligations.

It has long been market practice to appoint a third party, independent fund administrator to service open-ended hedge funds, and these investors recognise the real value of having such service providers. Now, private equity firms are following suit. Specifically, institutional investors are insisting a third-party fund administrator be appointed to provide independence and to ensure a fund's financial records are present and correct.

The use of up-to-date technology

In today's market, limited partners expect of the use of market-leading technology. Tech-savvy investors are demanding customised reporting and up-to-date fund administration software. This software needs to have the ability to trace data and report at each level of the private equity fund structure, from the underlying portfolio company back to the actual fund itself.

Investors want easier, instant and on-the-go access to current portfolio performance(s) through a self-service investor portal, including access through limited partners' smart phones.

Limited partners know the difficulties around onboarding so there is a demand for an automated digital investor platform. Fund administrators are now implementing this technology to ensure they can deliver a more efficient subscription and onboarding process – which can bring significant benefits for the investor experience and reduce the risk of compliance and regulatory violations. State-of-the-art technology can enhance the limited partner's experience, while overcoming the bottleneck concerns associated with manual workflows.

By outsourcing operations to a fund administrator, private equity firms – and in turn, limited partners – can take comfort in the use of the best-in-class systems that harness advanced technology. This also saves private equity firms from needing in-house systems and the costs surrounding onboarding, maintaining and the training of this software.

Reducing expenses and simplifying operations

Outsourcing daily operational matters greatly simplifies the management of a fund. Business Continuity Plan (BCP) considerations are off-loaded, as are data security, cash movements, and many other risk factors associated with internal operations. Outsourcing effectively reduces the vast majority of operational burdens to simply those of an oversight of a third-party vendor.

Private equity fund managers are also feeling the pressure to reduce their fees to secure limited partner commitments in the competitive fund-raising environment - and reducing costs can be achieved through outsourcing.

For example, internal staff used for the running of a fund are management company expenses. Outsourcing operations eliminates those salaries, bonuses, benefits, and other associated costs, including infrastructure and cybersecurity IT, from the management company and moves them to fund expenses.

Allowing investment managers to refocus on their skillset speciality

Limited partners are aware that investment managers' expertise lie in making investments and raising capital – not necessarily in overseeing operational functions. Understandably, limited partners would prefer managers to focus on their strengths.

Limited partners want their fund to have access to the extensive knowledge of a specialist – so outsourcing this element, leaves the investment manager to focus on what they do best.

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