Navigating the headwinds
2014 global private equity survey
in collaboration with PEI
Following the financial crisis, the private equity industry had to confront unprecedented difficulties. This inaugural global survey of private equity chief financial officers attempts to capture the impact of these challenges and how finance executives around the world have dealt with them. The findings not only provide useful insights and observations but also clearly demonstrate that firms are poised for growth and that chief financial officers are primed to overcome any obstacle.
When we approached this inaugural global survey, we anticipated its tone would ring of uncertainty and concern. In the aftermath of the financial crisis, nearly all finance executives faced exceedingly high expectations from investment professionals, increasing demands from investors and an unprecedented level of regulatory burden. Today’s chief financial officer (CFO) has been asked to mature in lockstep with the industry, steer progress along the path of institutionalization and seamlessly turn his or her focus toward future growth. Simply put, the CFO’s world has grown exponentially with the undeniable reality that he or she has to do more with less.

As a testament to the resilience and fortitude of finance executives around the globe, our initial apprehension proved to be unfounded. We discovered that private equity CFOs around the world have expertly navigated the headwinds of change with rigor, creativity and a relentless focus on operational efficiencies. Remarkably, these finance executives diligently worked to overcome unprecedented challenges and now, with cautious optimism, look to capitalize on the opportunities that lie ahead.

As the new year begins, CFOs are displaying a pervasive belief in near-term growth. Nearly four of five CFOs responded that their firm recently finished raising a fund, expected to raise another fund in the next three years and believed that the new fund will be of equal or greater value than the last. Respectful of the industry’s bullish opinion on growth, finance executives are acutely aware that successful operating models rest on their ability to proficiently manage resources and costs. Skills developed in the past several years will be stretched to new limits as they are compelled to scale the business with the right balance of people, process and technology. Surely, these will be interesting times for private equity CFOs.

To gain perspective on key priorities, we asked respondents to rank the factors used to review their job performance. Overwhelmingly, CFOs view themselves as most valuable when they interact with investment professionals and investors – supporting the recent expansion of their roles and responsibilities. Secondarily, CFOs remain accountable for managing costs, complying with regulators, retaining employees, and completing audits and tax filings. Back-office operations, while vital to the overall success of the firm, are best described as the “given” aspect of their job description.

### Rank the importance of factors used to review CFO performance.

<table>
<thead>
<tr>
<th>Factor</th>
<th>Most Important</th>
<th>Somewhat Important</th>
<th>Least Important</th>
</tr>
</thead>
<tbody>
<tr>
<td>Providing value to investment professionals</td>
<td>60%</td>
<td>44%</td>
<td>32%</td>
</tr>
<tr>
<td>Managing investor requests</td>
<td>24%</td>
<td>35%</td>
<td>36%</td>
</tr>
<tr>
<td>Managing internal costs</td>
<td>16%</td>
<td>32%</td>
<td>31%</td>
</tr>
<tr>
<td>Completion of audits with minimal issues</td>
<td>31%</td>
<td>38%</td>
<td>48%</td>
</tr>
<tr>
<td>Ability to retain employees</td>
<td>34%</td>
<td>48%</td>
<td>49%</td>
</tr>
<tr>
<td>Efficient tax filings</td>
<td>18%</td>
<td>31%</td>
<td>36%</td>
</tr>
</tbody>
</table>
Pushing through powerful waves of resistance, nearly all CFOs have been fatigued by global regulatory and tax reform. Seemingly unending legislation related to the Foreign Account Tax Compliance Act (FATCA), US Securities and Exchange Commission (SEC) registration, the Alternative Investment Fund Managers Directive (AIFMD) and carried interest taxation causes disruption on a daily basis. As finance executives search for a semblance of clarity, the vast majority muscle their way through cumbersome compliance exercises that steal chunks of time away from their day jobs. Accepting regulatory uncertainty as the latest trend in private equity, CFOs have largely resigned themselves to bear the bulk of the burden and minimize the impact to their firm.

Adding to layers of complexity, regulators and investors are separately mandating more information, faster. The levels of detail requested are substantive and often require customized reports. As demands on the back office grow, many CFOs have put their faith in, and to some extent feel dependent on, manual processes. These solutions somewhat satisfy their needs, but could be noticeably improved by the right technology at the right price. Finding a scalable, accurate and timely reporting process is not a luxury, but rather paramount to the firm’s long-term success and sustainable future growth.

In the past several years, market concerns and new accounting guidance have converged to produce permanent changes in the valuation process. To adapt, finance executives have increased their involvement in gathering data, synthesizing information, overseeing methodology and concluding on final measurements. CFOs are an integral component of the valuation committee, and relentlessly press to implement formal policies and procedures. As with other reporting regimes, certain manual processes are being converted to scalable, automated solutions to alleviate pressure and better respond to valuation questions from regulators, investors and accountants.

For most, back-office operations rely on lean staffing models complemented by efficient outsourcing. Overall, in the past year, firms hired predominantly in the investor relations, fund accounting and compliance/risk management areas. For the most part, CFOs feel that staffing levels are currently “just right” and consequently plan to hire fewer employees in the near future while outsourcing to fill certain gaps. Although staffing models have improved, finance executives foresee upcoming problems with controlling headcount and increasing costs.

CFOs recognize they face challenges concerning data, its collection, its accuracy and its use for multiple purposes. Not unique to private equity, these tactical and strategic challenges resonate throughout the asset management industry. Nearly all critical elements combine bits and pieces of manual, proprietary and vendor solutions, indicating substantial opportunity for operational efficiencies. Gradually, firms will see the technology dilemma to be less about costs and benefits and more about the finance team’s ability to rapidly scale systems with greater features and functionality.

We concluded the survey by asking finance executives to provide their global outlook of the future. Nearly all perceive wide-ranging uneasiness with regulatory uncertainty and the growing demands of investors. Yet, they believe their firms will cope with every burdensome requirement. With absolute determination, CFOs intend to enhance operational efficiencies to compress costs, scale infrastructure and set the stage for growth in a cautious but optimistic fashion. Finally, locked within the insightful perspectives of this inaugural survey, one theme fully embodies the view of private equity CFOs: a crystal-clear belief that they possess the passion, aptitude and vision to meet every future challenge and confidently navigate the opportunities and headwinds of tomorrow.
Regulation and compliance
CFOs clearly recognize private equity success factors

What do finance/operations executives see as the most concerning challenge over the next two years?

- Regulation and compliance: 45%
- Operational efficiency: 40%
- Managing investor requests: 10%
- Providing value to investment professionals: 5%

“At the start of this year, the firm’s senior partner brought me in to say that if we successfully manage our regulatory matters and the finance team is operating efficiently and effectively, I will have done my job.”

In the world of private equity, today’s decisions can have a profound impact on future growth. In that light, CFOs clearly understand the critical challenges that will influence their firms’ business and growth plans over the next two years. Not surprisingly, global regulation and compliance top the list, with operational efficiency a close second. These have been consistent concerns across the asset management industry, impacting private equity, alternative and traditional asset managers.

Forty-five percent of CFOs see regulation and compliance as their top concern entering 2014, citing increasing regulatory demands as a further drain on resources. These demands limit their ability to focus on key priorities. Interestingly while the majority of CFOs ranked “providing value to investment professionals” as the most important factor used to review their performance, only 5% said that it was the most concerning challenge over the next two years.

Furthermore, when finance executives express concern about global regulation, 40% indicate it may inhibit their ability to control costs and improve infrastructure. As a result, CFOs see cost control, hiring and retaining talent, and improving infrastructure as significant near-term concerns.
What is the expected impact of regulatory changes?

<table>
<thead>
<tr>
<th>Regulatory Change</th>
<th>High Impact</th>
<th>Medium Impact</th>
<th>Low Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>FATCA</td>
<td>55%</td>
<td>41%</td>
<td>4%</td>
</tr>
<tr>
<td>Registration of advisers</td>
<td>47%</td>
<td>17%</td>
<td>4%</td>
</tr>
<tr>
<td>AIFMD</td>
<td>45%</td>
<td>35%</td>
<td>6%</td>
</tr>
<tr>
<td>Tax treatment of carried interest</td>
<td>44%</td>
<td>48%</td>
<td>8%</td>
</tr>
<tr>
<td>Permanent establishment risk in foreign jurisdictions</td>
<td>6%</td>
<td>60%</td>
<td>26%</td>
</tr>
<tr>
<td>JOBS Act</td>
<td>26%</td>
<td>71%</td>
<td>3%</td>
</tr>
</tbody>
</table>

With new legislation and rule making on the horizon and related implementation deadlines approaching, many firms are actively working to understand global regulatory scrutiny, assess the impact to their business and define their compliance programs accordingly. This has been most evident with new registration and reporting requirements across the globe. For the first time, many firms have been required to register as advisers with the US SEC. This registration effort is further advanced in Europe as a part of the AIFMD. The toll does not stop with the registration requirements. Both regulatory regimes require ongoing compliance programs and certain regulatory reporting, including, but not limited to, Form PF (US) and AIFMD Risk Reporting (Europe).

Interestingly, 44% and 48% of CFOs view the potential change in the taxation of carried interest to be of high or medium impact, respectively, to their businesses. The threat of taxing carried interest at ordinary income tax rates has been looming for some time, and it has proponents and opponents on both sides of the aisle. Not surprisingly, such a change in law would have an impact on the after-tax remuneration earned by recipients of such income within the private equity community.
Managing risks, increased costs and performance returns

What is the most anticipated effect resulting from regulatory changes?

- Increase in costs: 83%
- Lower returns: 15%
- No impact: 2%

Has your firm undergone a regulatory presence exam or audit in the last 12 months?

- Not registered: 66%
- Presence exam: 18%
- Audit: 8%

The vast majority of CFOs continue to cope with the fallout from extraordinary regulatory change. Increased costs, impacts on returns, extraterritorial reporting and risks have been driving discussions with investment professionals and investors regarding the broad impact of regulation and the need for greater controls, transparency and resources.

As a result, 42% of new costs are passed on to the fund, with the remaining 58% borne by the firm. While there is no consensus as to whether increasing costs should belong to the fund or the firm, there is consensus that enhanced regulatory requirements directly impact overall expenses. Knowing the wave of regulatory changes will persist into the near future, it is safe to say that CFOs who can lower costs will have a distinct competitive advantage.

Approximately one-quarter of respondents indicated that their firms had undergone a regulatory presence exam or audit in the past 12 months. Industry expectations are that regulatory scrutiny will remain consistent in the near future.

“With any of the regulatory issues, it just takes more resources – resources that do not add value.”
There has been considerable attention in recent months regarding progress toward the adoption of the AIFMD. CFOs, recognizing the momentum, strongly communicated that the directive will not impact their firms’ fund-raising efforts. CFOs in Europe and Asia are more definitive in their position than those in North America since they have already dealt with the AIFMD and are determined not to leave money on the table.

Given the current July 2014 effective date, many North American firms have not yet assessed the costs and implications of transposition timing, transitional provisions and private placement marketing regimes before committing to an approach to fund-raising in Europe. As a result, North American firms, which are uncertain of the impact of the AIFMD, may elect “reverse solicitation” or “passive marketing” provisions instead of choosing to immediately comply with the directive. CFOs realize their firms should cautiously accept these provisions, as industry pundits and the European Securities and Markets Authority have indicated that reliance on these provisions is intended to be very limited.

FATCA is likely to impact private equity firms’ focus on legal entities and investors subject to the 2014 compliance guidelines. The overwhelming majority have consistently focused on FATCA requirements and feel the effects are manageable (72%) or easier than expected (12%).

Has the AIFMD reduced your firm’s likelihood to raise money in Europe?

<table>
<thead>
<tr>
<th>Region</th>
<th>Yes</th>
<th>Uncertain</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>18%</td>
<td>40%</td>
<td>42%</td>
</tr>
<tr>
<td>Asia</td>
<td>25%</td>
<td>75%</td>
<td></td>
</tr>
<tr>
<td>Europe</td>
<td>11%</td>
<td>72%</td>
<td></td>
</tr>
<tr>
<td>North America</td>
<td>17%</td>
<td>50%</td>
<td>33%</td>
</tr>
</tbody>
</table>

How difficult has it been to prepare for FATCA?

- **Manageable**: 72%
- **Easier than expected**: 12%
- **Very labor-intensive and complex**: 16%

“Being a non-EU fund manager, the lack of standard requirements and uncertainty surrounding the AIFMD places a real burden on us.”
In what compliance functions has your firm materially invested in the past 12 months or is planning to invest in the next 12 months?

<table>
<thead>
<tr>
<th>Compliance Function</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investor Reporting</td>
<td>38%</td>
</tr>
<tr>
<td>Regulatory Reporting</td>
<td>36%</td>
</tr>
<tr>
<td>Marketing Material/Collateral</td>
<td>35%</td>
</tr>
<tr>
<td>Personal Account Trading</td>
<td>33%</td>
</tr>
<tr>
<td>Email and Social Media</td>
<td>17%</td>
</tr>
<tr>
<td>Material Nonpublic Disclosures</td>
<td>11%</td>
</tr>
</tbody>
</table>

Measured and evolving investment in compliance functions

For the most part, CFOs invest moderately across all compliance functions. Tactically, spend has been primarily allocated to externally focused areas, such as investor reporting, regulatory reporting and marketing material/collateral.

Given the mandate for firms to provide additional data and metrics to regulators and investors, it is not surprising that reporting requirements have dictated compliance spend to date. With respect to the notable spend on marketing material and collateral, the US SEC, AIFMD and the JOBS Act have all significantly changed the solicitation landscape, resulting in expanded marketing and fund-raising capabilities at the cost of added compliance.

CFOs sense that incremental focus and spend could be directed on internal operations with significant attention paid to personal account trading. As expanding regulatory and investor regimes develop, even more quantitative data requirements await, likely resulting in sizable compliance budgets deemed a necessary cost of business.

CFOs realize their firms continue to evolve culturally in an unfamiliar, highly regulated environment and, as regulatory burdens intensify, they expect compliance efforts to mature into a critical aspect of risk management.

“In terms of compliance, we moved to a dedicated compliance function and added a technology solution to better archive and manage.”
Valuation and financial reporting
### Enhancing the valuation process

**What percentage of firms have a valuation committee?**

<table>
<thead>
<tr>
<th>Region</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>65%</td>
</tr>
<tr>
<td>Less than US$1b</td>
<td>47%</td>
</tr>
<tr>
<td>US$1b-US$10b</td>
<td>51%</td>
</tr>
<tr>
<td>Greater than US$10b</td>
<td>71%</td>
</tr>
<tr>
<td>North America</td>
<td>75%</td>
</tr>
<tr>
<td>Europe</td>
<td>61%</td>
</tr>
<tr>
<td>Asia</td>
<td>11%</td>
</tr>
</tbody>
</table>

**Describe the involvement of the investment team, CFO and finance department in preparing valuations.**

<table>
<thead>
<tr>
<th>Team</th>
<th>Highly involved</th>
<th>Somewhat involved</th>
<th>Not involved</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment team</td>
<td>75%</td>
<td>24%</td>
<td>1%</td>
</tr>
<tr>
<td>CFO</td>
<td>72%</td>
<td>23%</td>
<td>5%</td>
</tr>
<tr>
<td>Finance department</td>
<td>53%</td>
<td>33%</td>
<td>14%</td>
</tr>
</tbody>
</table>

Are external specialists involved in your firm's valuation process?

**Mindful of inquiries from regulators and investors, firms have looked to CFOs to enhance their valuation processes. Valuation committees, often seen as the first sign of change, have taken shape to influence the development of formalized policies and procedures. In fact, 65% of firms have established formal committees, with a noteworthy exception in Asia, where only 11% of firms have supported the trend.**

Further evidencing change, CFOs are more involved than ever in preparing and finalizing investment valuations. Seventy-two percent are highly involved, contributing to all aspects of the process. By dividing important elements that extend from gathering portfolio company data to establishing guideline companies or devising models, CFOs have created a complementary atmosphere between the investment team and the finance department.

Perhaps in the future, finance executives will engage the use of external specialists to value investments; however, CFOs made it clear they do not believe the current benefits are worth the time or the cost. Rather, they feel the significant involvement of their finance departments has created the necessary capacity to fulfill their firms' valuation responsibilities.

“Our valuation committee is run as a formal, well-established process. I challenge the assumption first, that way only the most unorthodox cases earn the committee's full attention and counsel.”
Investment teams and CFOs realize the importance of an efficient process to collect accurate portfolio company information. Ninety-two percent of firms prefer to manually obtain data through investment teams, standardized templates or a centralized middle office, refraining from automated solutions as a practical alternative.

Approximately three out of four firms validate portfolio company operating results through discussions with the investment teams or through comparison of board materials with management. Most firms analyze financial data by measuring actual results to budget (65%) or to prior year (60%), providing helpful insight and context.

As time progresses and finance executives become further involved in portfolio company valuations, CFOs may move toward scalable solutions so human capital can be deployed more efficiently. Time is truly valuable, and if information is obtained in a systematic manner, investment teams and CFOs can spend more time analyzing, as opposed to collecting, portfolio company operating results. Regardless of whether firms use manual or automated methods, current practices rely heavily on portfolio managers, thus requiring effective communication among investment professionals, finance executives and the middle office.

CFOs see portfolio valuation as principally manual

How does your firm obtain portfolio company operating results? If manual, by what means is it gathered?

- Valuation process
  - Automated: 8%
  - Manually: 92%

Data obtained by

- Respective investment teams: 54%
- Standardized template: 28%
- Centralized middle office: 18%

How does your firm validate portfolio company operating results?

- Discussion with portfolio manager responsible for portfolio company: 79%
- Compare to board materials and discuss with portfolio company management: 71%
- Compare actual to budget: 65%
- Compare actual to prior year: 60%
Assessing key valuation risks, assumptions and judgments

What key valuation risks exist in your firm’s valuation process?

Portfolio company data

<table>
<thead>
<tr>
<th>Risk</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Untimely reporting</td>
<td>51%</td>
</tr>
<tr>
<td>Inadequate quality of reporting</td>
<td>35%</td>
</tr>
<tr>
<td>Inadequate process of gathering data</td>
<td>16%</td>
</tr>
</tbody>
</table>

Methodology and approach

<table>
<thead>
<tr>
<th>Risk</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assumptions and models</td>
<td>56%</td>
</tr>
<tr>
<td>Volatility and selection of comparables</td>
<td>33%</td>
</tr>
<tr>
<td>Triangulation of multiple valuation approaches</td>
<td>26%</td>
</tr>
<tr>
<td>Value minority investments</td>
<td>9%</td>
</tr>
</tbody>
</table>

“The fact is, we’re so intimately involved in the operations of our portfolio companies, we know our valuations like we know our name.”

Understanding that valuing portfolio companies involves substantial judgment, CFOs face real challenges to meet the expectations of investment professionals, investors, regulators and auditors.

Fifty-one percent of CFOs believe that untimely reporting by portfolio companies presents a substantial valuation risk, and 35% consider inadequate quality of reporting as a threat to their processes. Inherently, if firms do not receive timely and accurate portfolio company data, they risk reporting erroneous values to stakeholders – an unpleasant oversight. CFOs also indicate they could better gather data by standardizing portfolio company requests and increasing the frequency of communication with the firm’s portfolio managers.

When assessing valuation methodologies and approaches, 56% of finance executives rank the subjective nature of assumptions and models as their primary concern. As a critical component to formulating values, CFOs believe volatility and selection of comparable companies (33%) or the triangulation of multiple valuation approaches (26%) often jeopardize the precision of their judgments.
CFOs indicate that stakeholders, primarily investors and regulators, encourage full valuation procedures on a recurring basis. In response, investment professionals, CFOs and valuation committees have developed new policies and processes – most importantly, the approval of values by multiple parties. Like many other demands, full, quarterly valuations have drained resources and underlined the need to expand the responsibilities of finance executives.

Demonstrating the importance of this process, two-thirds of private equity firms prepare full valuations on a quarterly basis. More specifically, 76% of firms with greater than US$10b of assets under management prepare quarterly, as do 73% of those located in North America.

Somewhat differently, less than half of the firms in Europe and those with less than US$1b of assets under management perform quarterly valuations. Very differently, 45% of firms located in Asia rely on an annual process.

“CFOs encourage robust valuations on a quarterly basis”

At what frequency are full valuation processes performed, including documentation of individual portfolio company values and approval by a managing director or valuation committee?
Most firms issue annual audited financial statements in 90 days

Approximately how many days after year-end are audited annual fund financial statements issued to investors?

Regionally, and for all categories of assets under management, the vast majority of firms issue annual audited financial statements within 90 days. Within this 90-day time frame, 12% report in less than 30 days, 16% report between 30 and 60 days, and 60% report between 60 and 90 days.

CFOs remain mindful that nearly all US SEC-registered advisers are required to issue audited financial statements within 120 days of year-end. Widely known as the “audit exemption,” it is used by CFOs in lieu of the inconvenience of a surprise security count. In the past few years, the audit exemption, combined with terms in most limited partnership agreements, has resulted in the 90-day target.

Reporting of fund of funds and unregistered advisers account for audited annual financial statements issued beyond 90 days.
Regionally, and for all categories of assets under management, the vast majority of firms issue quarterly financial statements within 45 days. Within this 45-day time frame, 11% report in less than 30 days and 65% report between 30 and 45 days. Outside of the 45-day standard, 18% issue between 45 and 60 days and 6% issue between 60 and 90 days. CFOs in Asia indicate that 100% of their firms’ quarterly financial statements are delivered to investors within 45 days.

Finance executives have significantly enhanced their firms’ quarterly reporting processes, including recurring quarterly valuations. For that reason, most CFOs do not consider the 45-day deadline to be problematic as long as their teams collect portfolio company data in a timely manner.

Fund of funds and unregistered advisers explain the 18% of firms with more than US$10b in assets under management that issue quarterly financial statements in 90 days.

Most firms issue quarterly financial statements in 45 days

Approximately how many days after quarter-end are quarterly fund financial statements issued to investors?

<table>
<thead>
<tr>
<th>Region</th>
<th>Less than US$1b</th>
<th>US$1b–US$10b</th>
<th>Greater than US$10b</th>
</tr>
</thead>
<tbody>
<tr>
<td>North America</td>
<td>12%</td>
<td>14%</td>
<td>56%</td>
</tr>
<tr>
<td>Europe</td>
<td>7%</td>
<td>16%</td>
<td>11%</td>
</tr>
<tr>
<td>Asia</td>
<td>6%</td>
<td>6%</td>
<td>18%</td>
</tr>
</tbody>
</table>
Describe the level of your firm’s footnote disclosure in quarterly financial statements.

CFOs were asked to describe their firms’ current practices for disclosing information contained in quarterly financial statements. Practices vary significantly, and a standard has yet to be developed. Notably, CFOs in Asia (67%) and those of firms with assets under management between US$5b and US$25b (53%) responded their firms do not include footnotes in their quarterly financial statements. All other CFOs indicated quarterly information to be more forthright, describing their firms’ level of quarterly disclosure as partial or full footnotes.

With stakeholders requesting more information, firms have found it useful to leverage annual financial statements by producing meaningful levels of disclosure on a quarterly basis. Clarity, in the form of footnotes, can often allow CFOs to alleviate one-off requests from investors.
CFOs split evenly on the use of tax estimates

In order to distribute timely K-1s to investors, what percentage of firms use estimates from “flow-through” investments?

Not surprisingly, CFOs’ decisions to use tax estimates are equally mixed. Many firms hold investments in portfolio companies through limited partnerships and limited liability companies where taxable income/loss passes through to the fund. In order to prepare their own K-1s, firms are dependent on the timely delivery of K-1s from portfolio companies. If K-1s are not provided in a timely manner, the firm may instead opt for tax estimates to replace final portfolio company information.

The use of estimates is often predicated on the firm’s ability to not only obtain timely information from the portfolio companies but also receive accurate tax data. In many cases, portfolio companies are not willing, or able, to meet the requirements of the firm, especially when delivery of information is dependent on the firm’s level of control. Further complicating the issue, the US Internal Revenue Service does not state that estimates may be used to report K-1 taxable income/loss to investors.
Operational efficiency
Staffing levels as reflected in comparative operating models

Average ratio of non-finance employees to investment professionals

Average ratio of finance employees to investment professionals

Average total number of employees

“The bottom line is that we’re having to do more with less. We grew significantly while adding limited headcount. It’s not a choice. We have to do that.”

Firms with more than US$10b of assets under management comparatively maintain higher levels of employees. This is principally because smaller firms, unlike their larger counterparts, are forced to limit hiring and control costs.

In contrast, CFOs acknowledge that the larger the asset base, the more complex reporting becomes for regulators and investors. For these firms, irrespective of geographic location, the number of finance and non-finance employees substantially grew given the multiple types of asset classes, multiple locations in which they operate and, in limited instances, the requirements of public reporting.

Headcount ratios of finance to investment professionals are reflected within the range of 0.40 to 0.58, demonstrating that their finance teams are consistently operating at lower ratios than non-finance employees who operate at ratios to investment professionals between 0.27 to 0.85 (the ratio of 0.27 results from firms based in Asia).

Although finance executives have realized certain efficiencies from previous efforts to leverage existing employees, CFOs remain laser-focused on the mandate to continually scale and manage increasing costs.
Specifically for finance/operations, have resources been added in the last 12 months, are they expected to be added in the next 12 months, or have they been outsourced to third parties?

More than 80% of CFOs, aggregated by assets under management and geography, expressed their sense that current staffing levels are “just right.” In fact, across all functions outside of tax and valuation, CFOs intend to hire fewer professionals this year than last. In areas where they expect to hire next year, firms are generally searching for specialized competencies in fund accounting (26%), investor relations (24%), compliance/risk management (17%), and portfolio analytics (17%).

As a means to efficiently utilize their professionals, CFOs proficiently outsource specialized functions, or parts of these functions, such as technology (72%), tax (66%) and fund accounting (44%). Many finance executives are pressed for time and stretched thin by regulatory, investor and internal demands. Consequently, they continue to pursue the right balance of internal staffing compared with external roles and responsibilities. Given their importance, CFOs are generally reluctant to outsource investor relations, treasury functions, portfolio analytics and valuation.
CFOs remain uneasy with today’s technology and are searching for the right solutions

What are your firm’s major technology concerns?

- Systems do not interface: 53%
- Should be getting more out of existing systems: 47%
- Scalability: 42%
- Too expensive: 32%
- Information reliability: 27%
- Requires specialized knowledge; difficult to use: 23%
- Implementation risk: 23%

Describe your firm’s overall technology capability.

- Manually intensive: 22%
- Combination of manual and automated: 62%
- Good to high automation: 16%

The technology concerns facing CFOs resonate beyond private equity to the broader asset management industry. Finance executives recognize that systems interfacing with one another (53%), production (47%) and scalability (42%) are critical to enhance overall technology capabilities. By cost-effectively achieving higher levels of interaction among systems, CFOs can move past manual processes to automated solutions, resulting in greater features and functionality.

Twenty-seven percent of CFOs rank information reliability as a major technology concern. Although seemingly less prevalent than others, information reliability can also be tagged as Big Data, including essential topics such as data availability, data accuracy, timeliness, and, more broadly, data management and governance. Many finance executives agree that in the long run Big Data will be seen as essential to efficient and effective firm operations.

As CFOs look beyond automation as a tactical tool, technology is likely to emerge as a key strategic priority. Such technology will attract the attention of investment, middle-office and finance executives to debate the risks, costs and benefits of implementing change.

“For much of our work, we use off-the-shelf vendor technology and outsource key functions to external firms. Based on our level of complexity, this combination presents too great a risk of error.”
To many finance executives, blending vendor products and in-house systems often leads to a lack of integration. In many cases, CFOs express frustration in a technology gap that exists between CFO expectations and today’s private equity solutions. Such solutions remain more effective in supporting specific functions instead of the firm’s entire operation.

When evaluating the satisfaction of 13 different technology functions, CFOs generally are somewhat satisfied with their firms’ respective system solutions. Across the various areas, firms using vendor products typically indicate higher satisfaction rates than those using proprietary or manual systems. In particular, accounts payable, management company accounting, fund accounting, contact management and investor relations systems recorded high scores.

In comparison to the vendor system norm, CFOs deploying manual systems feel somewhat satisfied with performance tracking, treasury and cash management, valuation, and portfolio management functions. The sentiments expressed in these areas seem to be the product of marginal technology capabilities, signaling opportunities for innovative and scalable solutions.

Across every technology function, CFOs experience differing levels of satisfaction, survive with system constraints and deploy a wide array of solutions.

By function, describe your firm’s level of technology satisfaction and identify whether your firm uses vendor, proprietary or manual systems.
Performance tracking

Tax reporting

Treasury and cash management

Investor relations

Valuation

Investment sourcing

Portfolio management

Accounts payable and invoicing

Management company accounting

Fund accounting

“I don’t want to invest in a new platform unless my fellow CFOs have said they’re using it and find the platform valuable.”
Even though firms typically allocate less than 5% of annual budgets to technology spend, investments are generally made to solve a particular problem rather than build a strategic solution. Given the rapidly changing dynamics in private equity, it is not surprising to see firms cautiously approach technology transformation.

Regulatory compliance continues to influence technology spend. Investments in sales and marketing support (28%) and legal/compliance (30%) are driven by both external and internal demands. In light of that, many existing and potential investors are asking for improved communication and reporting regimes, causing firms to upgrade capabilities to raise capital in the current regulatory and competitive environment.

Data warehousing and investment management technology is immature, but CFOs realize that implementing these systems could pay significant dividends in the future. As assets under management grow, so do data requirements and reporting burdens. The CFO that plots this course in an effective manner will be rewarded with real benefits in the long run.

"Most technology solutions are very costly. Other firms may have technology spend to cover their needs, but we are forced to design our own solutions."

CFOs strive to make the most of technology budgets

What is the technology allocation (maintenance or capital investment) of your firm's annual budget?

In what areas has your firm made large technology capital expenditures in the past 12 months or plan to make in the next 12 months?

“In most technology solutions are very costly. Other firms may have technology spend to cover their needs, but we are forced to design our own solutions.”
Outlook
CFOs cope with a multitude of business challenges

Describe the impact on finance/operations from challenges over the next two to three years.

- Regulatory environment: 62% major impact, 37% some impact, -1% no impact or N/A
- Competition for fund-raising: 36% major impact, 50% some impact, 14% no impact or N/A
- Investor demands such as increased transparency: 30% major impact, 68% some impact, -2% no impact or N/A
- Investment activity: 27% major impact, 67% some impact, 6% no impact or N/A
- Managed account platforms: 7% major impact, 40% some impact, 53% no impact or N/A
- ILPA guidelines: 7% major impact, 81% some impact, 12% no impact or N/A
- Asset diversification: 3% major impact, 48% some impact, 49% no impact or N/A

Nearly two-thirds of CFOs believe that the regulatory environment will impact their operations over the next two years. A new regulatory landscape and increasing legislation, including but not limited to cross-border reforms aimed at harmonization and stability, have created a wave of uncertainty affecting nearly all business decisions. European firms will most keenly feel adverse effects of regulatory and compliance requirements such as the AIFMD and FATCA.

Rounding out the top four business challenges, CFOs ranked competition for fund-raising, investor demands and investment activity at 36%, 30% and 27%, respectively. By directly and indirectly impacting growth, these factors demonstrate that firms are poised to raise capital. CFOs realize that growth is married to competition, so the level of investor due diligence will likely be more invasive than ever before.

“The buck stops here. My job is about using my creativity and forward thinking to devise the best way to run our operations for our investment professionals.”
The mandate and strategy of today’s CFO is to refine operating models to be more efficient, effective and adaptable to the rapidly changing private equity industry. Firms are achieving scale through more efficient use of processes supported by increased utilization of technology. As a result, finance executives are expected to develop both innovative tactical and strategic solutions.

CFOs are moving away from relying on people to support growth and business operations, instead looking to improve processes and invest in technology. In every category, enhancing processes was viewed as the most important priority to support business operations.

For many firms that perform finance functions in-house and internally manage investor relations, the mounting reporting burden is likely to enhance current data requirements and accelerate the frequency for which a firm reviews and verifies investor information. Sequencing process and technology efforts in accordance with business milestones can help reduce human capital costs and lead to more manageable operations for many firms.

In support of your firm’s business strategy, prioritize finance/operations investment in people, process and technology over the next 12 months.

“Continual improvement of our processes and procedures will always be my chief priority.”

CFOs strategically focus on people, process and technology

In support of your firm’s business strategy, prioritize finance/operations investment in people, process and technology over the next 12 months.
Private equity firms prepare for precipitous growth in capital

In what year was your firm’s most recent fund closed?

<table>
<thead>
<tr>
<th>Year</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>2010</td>
<td>8%</td>
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<tr>
<td>2011</td>
<td>12%</td>
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<tr>
<td>2012</td>
<td>20%</td>
</tr>
<tr>
<td>2013</td>
<td>40%</td>
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</table>

Does your firm offer exchange-listed fund(s)?

- Yes: 2%
- No: 87%
- No, but contemplating: 11%

CFOs believe the industry continues to mature and those firms that expertly handled the financial crisis will thrive. Recent lessons learned have driven many firms toward growth despite the constantly changing economic climate, increased regulatory burden and high expectations of investors. Notably, 80% of firms have raised capital in the last four years, with 40% closing a fund in 2013.

Clearly, the fund-raising environment remains extremely competitive. CFOs have met the challenges by responding to investor demands in a timely and thorough manner. In many cases, CFOs indicated that growth in the past four years has resulted in heavier workloads; however, in this environment, budgets have not typically allowed for appropriate resources, meaning employee retention is more important than ever.

The reality is that CFOs are finding new and creative ways to bring value beyond the finance department as evidenced by their interaction with investment professionals and investors. Superior performance always attracts capital, so it is no surprise that CFOs view their performance primarily shaped by value brought to the front office. Traditional finance functions have turned into secondary priorities, yet operational efficiencies remain critical to realize economies of scale.

“We just closed the largest fund we have ever raised. My next responsibility is to manage a number of new investors including the unique needs of sovereign wealth funds.”
CFOs are bullish about future opportunities and growth. More than 80% of firms intend to raise capital in the next three years. In addition, the large majority of these CFOs expect their firms’ subsequent fund to either be equal to (45%) or larger than (39%) their last.

In order to grow, firms largely choose to invest in their core strategies; however, many have diversified slightly to reap the rewards of new capital. Front-office and investor demands place further pressure on CFOs to meet the increasingly high expectations of investment professionals. Undoubtedly, finance executives know they must improve processes, invest in technology and retain employees to successfully handle the expanding burden on their teams.

As a testament to their resilience, CFOs have met all challenges head-on. Today’s finance executive heavily interacts with investment professionals and investors while managing an efficient and effective operating model. The versatility and adaptability CFOs have displayed in the last five years demonstrate they will not only champion their firms’ future growth but will confidently navigate the headwinds of tomorrow.
Background and methodology
Background

The purpose of this survey is to document the views, insights and observations of chief financial officers and finance executives globally. Topics in this survey include business challenges; regulatory and compliance burdens; valuation and financial reporting; investments in people, process and technology; and the future outlook of the private equity industry.

Methodology

PEI conducted:

- An online survey to which 105 chief financial officers and finance executives responded from August to October 2013, with principally all regions of the globe and all categories of assets under management represented.
- 33 telephone interviews with chief financial officers and finance executives from September to November 2013, covering nearly all regions of the globe and all categories of assets under management.

For several of the questions, multiple answers were allowed, resulting in responses that do not add up to 100%.
EY contacts
PEI contacts
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PEI is the only global B2B information group focused exclusively on private equity, private real estate, private debt and infrastructure. As these four asset classes continue to grow in scale and significance — for investors, fund managers, financial practitioners and other service industries globally — so PEI is positioned to provide unparalleled business knowledge and intelligence to these communities.

Formed in London in November 2001, when a team of managers bought out a group of assets in an MBO from financial media group Euromoney Institutional Investor PLC, PEI has enjoyed more than 10 years of growth and continued to expand steadily. Owned entirely by people who work in the business and with offices in London, New York and Hong Kong, we publish five globally-recognized magazines alongside five news websites, manage what is probably the most extensive set of databases dedicated to alternative assets, run more than 30 market-leading conferences globally, publish a large library of specialist books and directories, and operate a significant training business.

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We would like to extend our thanks to all of those who made this inaugural global private equity survey possible. We are pleased with the overwhelming response to the survey, and the results demonstrate the strength and determination of the industry, as well as of the professionals who have been an integral component of its growth. EY is proud to bear witness to the dynamic changes taking place in private equity and the enthusiastic outlook on the future of the industry. As challenges continue to arise, we are confident that CFOs have the tools to steer their businesses successfully into the future.

PEI is proud to partner with EY to create this landmark survey. Over a decade ago we began to focus on the vital functions of the CFO’s role and have seen the responsibilities expand from the limited scope of managing the finance and reporting functions to playing a leading part in the institutionalization of today’s private equity industry. CFOs are now providing value to every aspect of the private equity firm’s business, and similarly we look forward to continuing to deliver actionable intelligence to the global CFO community through our conferences, magazines, online news and research through the next decade and beyond.