

KEYNOTE INTERVIEW

Delivering the benefits of scale to the mid-market



*Differentiated partnerships can help GPs remain competitive and stay independent, say PACT Capital Partners co-founders **Christian von Schimmelmann** and **Brian Vickery***

Q How has the GP stakes market evolved over time, and what implications does that have for managers and investors today?

Christian von Schimmelmann: The GP stakes market as you see it today started to take shape back in 2013, initially with larger private equity firms seeking external capital. In those early days, GP stakes firms didn't require the level of differentiation that today's market demands. Now, as the market

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has grown, specialization has become essential.

Early on, it was quite hard for GPs to understand the differences between GP stakes offerings and how each firm could support them. LPs were also wondering whether a GP stakes transaction would change the culture of an underlying manager and whether firms

that chose to sell a minority stake were in some way struggling. Over time, as successful GPs decided to sell stakes – and continued to thrive post-transaction – LP sentiment shifted from “why do this?” to “why haven't you sold a stake yet?”

Today, GPs have become very sophisticated in evaluating the nature and structure of GP stakes transactions. GPs today typically think very carefully about how much capital is required to accomplish their objectives, how to

structure each transaction, and how to achieve the alignment they are seeking with their LPs.

Looking forward, we see the largest opportunity in the mid-market where there is a real need for strategic capital, as less than 5 percent of firms have sold a stake to date and only about 20 percent of all capital raised by GP stakes funds belongs to firms focusing on this market segment.

Q How important are cultural and personality fit factors in selecting a partner?

CvS: Trust and cultural fit are among the most important considerations for any firm seeking a strategic partner. Selling a stake is not just an M&A transaction – it's the beginning of long-term partnership and hence a deeply personal decision.

At the end of the day, GPs are seeking a strategic partner who reinforces, rather than changes, the culture of the underlying business that they, in most cases, have spent years cultivating.

Given that context, credibility, deep industry relationships and extensive GP stakes experience are critical requirements for a successful GP stakes investor. As GPs talk to one another, having a track record and reputation of being a good partner who delivers on its promises are critical and enable all parties to build the requisite trust to set the stage for an aligned and successful partnership.

Q What new capabilities are GP stakes firms bringing to their partner firms, beyond capital?

Brian Vickery: Mid-market PE firms are highly focused on the value-add capabilities that a GP stakes partner can offer. These firms are often earlier in their journeys, tend to be founder-led, and, given the room and tools to grow, have the potential to outperform and create outsized value for their portfolio companies and for their LPs.

Q What role does AI play in supporting both GP-level and portfolio-level value creation?

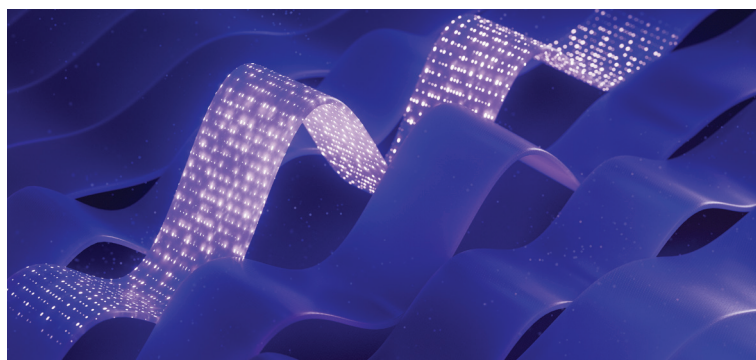
BV: We see the industry moving quickly from experimentation to value creation. Eighteen months ago, GPs were running small experiments and watching what others were doing, but that has quickly evolved to identifying and leaning into full implementation to avoid falling behind.

At the firm level, investment, investor relations, and operations teams are streamlining key processes across fundraising (eg, RFPs), sourcing, diligence, and internal reporting (eg, synchronizing data across the portfolio), among other use cases. The first few days of commercial due diligence, for example, can now be compressed into a matter of hours, allowing investment teams to focus their time on the highest-priority opportunities.

At the portfolio company level, embedding AI is quickly becoming an integral part of value creation roadmaps, and that concept seems likely to make its way more and more into the initial underwriting of many transactions – in some cases, leaning into AI-led value creation may be the difference in winning a transaction. Firms today are building and assembling core AI capabilities, and that process can be accelerated and de-risked with the right partner.

Firms like ours have relationships with high-quality services and technology firms that give GPs access to thousands of practitioners that can engage at the right moment and with the right expertise, including to embed AI at both the firm and portfolio level.

Still, while GPs are certainly investing in AI more today than just a short while ago, we believe that we are in the early innings related to what can and will be done.



While large firms benefit from their own scale, a GP stakes partner can help bring critical scale advantages to mid-market firms while enabling them to remain focused and stay independent.

Specifically, mid-market firms can often benefit from support in areas such as capital formation, product development, expansion into new

geographies, talent attraction, tech selection and adoption, or portfolio value creation.

For example, mid-market firms often want to increase their domestic investor bases and access new channels, such as additional regions around the world or new types of capital, including retail and semi-liquid permanent capital. Similarly, growing organizations

also typically need to evolve how they attract and manage talent, moving beyond reasonably small teams with whom daily operational processes evolve organically. Increasing professionalization while maintaining culture isn't always an easy task.

Q What are the main strategic reasons a GP might pursue a stakes transaction today?

CvS: One of the most common reasons is to make larger GP commitments, which can be an important statement in increasing alignment with LPs in a challenging fundraising market. Specifically, the distributions that GPs have traditionally relied on to fund their businesses and make future GP commitments have slowed considerably, and the need for external capital has perhaps never been greater and more apparent.

Another reason is to evolve their platforms, which may mean supporting adjacent products that leverage domain expertise or enabling geographic expansion in a way that invests in people and expertise that can increase the probability of success. If executed well, those expansions can make franchises stronger and deepen relationships with investors.

Finally, we see GPs being much more thoughtful about succession planning, including gradual transitions to the next generation. GP stakes firms can play a critical role in helping GPs manage transitions effectively and equitably, ensuring that the next generation has the capital and strategic support it needs to continue the firm's success.

BV: We also believe that the right partnerships are an investment in the capabilities that firms need to compete. Bringing in the right partner can be a reason in itself to execute a deal, to gain access to enhanced capabilities, support and advice that can help them scale effectively and efficiently.

“GPs are seeking a strategic partner who reinforces, rather than changes, the culture”

CHRISTIAN VON SCHIMMELMANN

Q How do you ensure alignment among key stakeholders - particularly limited partners and key employees - when executing a GP stakes transaction?

CvS: For PACT, alignment is important not just between us and the GP, but also between the GP and its LPs. It is about making our partner businesses stronger for the long term.

We start by considering the aggregate ownership percentage that should be held externally. The whole premise is making sure the vast majority of the economics remain with the team – we want to be aligned with the owners of the firm, and we want those owners to retain sufficient economics to recruit and retain the best team possible.

We also think about the use of capital. When capital is used to support and evolve the business, we see great alignment. Conversely, if the primary goal of a GP stakes transaction is to generate liquidity for founders, the alignment can be less clear.

Finally, as a minority investor, we carefully structure our investments to achieve maximum possible contractual alignment with our partner firms. If approached constructively, we have generally found that there is genuine buy-in from partner firms to achieve a fair and equitable structure that ensures contractual alignment for all stakeholders.

It is also important GPs communicate the merits of a transaction thoughtfully to their constituents. While LPs are far more supportive of GP stakes deals today than before, they still want to know why a GP has sold a piece of its business and what it intends to do with the proceeds. When the answers are strategic and compelling, the transaction can strengthen LP relationships.

Q What are the most significant potential conflicts of interest in GP stakes strategies, and how should they be managed?

BV: Conflicts most commonly occur when a GP stakes investor is part of a broader platform that has other, potentially competing, investment strategies. The market today demands expertise, and a firm like ours tries to bring the very best experts to help our partner firms pursue opportunities.

CvS: The question of independence brings us back to the earlier point about culture. The culture we are building as a firm resonates with the GPs that we speak to because often they have been through that journey themselves. It's all about providing the right capital to the right firms for the right reasons, building strategic partnerships and adding value to help firms achieve their goals. ■