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Private Equity Now: The Distribution Dilemma

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Having focused this year mostly on the effects of rates and the economy on private credit, it's time to turn our attention to private equity. One of the more surprising aspects of conversations around this topic is how PE has taken a back seat to PC, particularly regarding growth and performance of the asset class. Yet to understand the dynamics of fundraising and deployment of one you need to understand them for the other.

It's no secret that the past few years have been marked by a sharp drop-off, some say a cessation, in private equity distributions. From 2021 to 2023, the median hold period for a private equity portfolio company grew over 20% to nearly 6.5 years. Sparked by the dramatic rise in interest rates, macroeconomic shocks such as COVID and inflation, and the corresponding slowdown in M&A, the so-called flywheel of private equity investing has been disrupted.

Over the next several weeks, we'll explore the "distribution dilemma" from the perspectives of both GPs and LPs. With distributions in short supply, both sides of the private equity trade are compelled to make tough decisions and wrestle with new challenges. On the GP side, it seems as if only higher quality assets are transacting, while dry powder remains at peak levels.

How can they continue to return capital to investors and avoid disruption to their fundraising cycle? Can GPs and LPs collaborate to meet their common goals? How can financial tools be employed creatively to generate liquidity for all constituents?

Similarly, as LPs wait for distributions to re-deploy to their private equity programs, they scrutinize any new allocations or commitments. How should LPs prioritize their precious capital? What strategies will prosper from here, and how do you adjust your portfolio mix to factor that in? What are the future return expectations in periods of extended holding periods? These are questions managers and allocators are asking themselves and we will explore in this series.

Over the last ten years the private equity industry has adapted. Tools have emerged for both GPs and LPs to improve liquidity and fill the distribution hole; most notably LP-led secondaries, continuation vehicles, and NAV financing facilities, among others. In today's market, cutting back on new deployment and waiting for distributions is not the only or best course of action. This series will explore the options available, how the best GPs and LPs are navigating the distribution crunch.

What remains to be seen are the longer-term, structural impacts of the distribution dilemma. We expect that investors who pull back from the asset class will miss out – as we have seen play out in other market disruptions. Out of current market complexity will emerge clear winners and losers. For LPs in particular, those with scale, diversified portfolios and a disciplined focus on quality will best adapt and thrive.