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Looking Ahead to the Future of M&A

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As private equity firms and advisors prepare for future mergers and acquisitions (M&A), it is vital to have legal partners by their sides. By hiring the most suitable legal partner for their specific M&A, firms are able to successfully respond to regulatory oversight and compliance mandates, as well as a potential recession and ever-increasing transparency requirements. Jaclyn Grodin, a commercial litigator, represents private equity firms and advisors in disputes, including those involving financial fraud and partnership and investor actions. Meanwhile, Allison Sherrier, a corporate attorney, represents public and private companies in M&A and corporate restructuring. Both are highly experienced in advising clients about private equity fund formation.

CRAIN’S: What are the biggest obstacles for middle market private equity firms when it comes to accounting for increased regulatory oversight and compliance mandates?

JACLYN GRODIN AND ALLISON SHERRIER: Overhead costs, associated with ensuring regulatory compliance for private equity firms, always require advisers and compliance officers to weigh the costs and benefits of changes to compliance regimes, regardless of the size of the firm. The SEC’s recently enhanced private fund exam and enforcement priorities, however, should lead middle market firms, in particular, to assess their current policies and procedures, in order to identify areas where they can implement more efficient processes and streamline redundancies. In doing so, firms will be able to pivot more easily if—and when—rule changes come into effect. If firms wait for the implementation of new rules without considering how those amendments will affect their compliance costs, they will be at a disadvantage.

CRAIN’S: How are private equity funds adapting to growing investor demands for greater transparency from advisers and competition in the area of fees and expenses?

JACLYN GRODIN AND ALLISON SHERRIER: Investor demands are broadening competition in the private equity space, while simultaneously increasing the potential for complaints to regulatory agencies. When funds are more willing to provide investors with detailed analyses of fees and expenses, they can set themselves apart from similarly situated funds and become more attractive investment options, particularly for institutional investors. At the same time, more detailed disclosures increase the potential for inadvertent omissions or incomplete information, thereby opening another avenue for investor discontent. Firms are trying to balance satisfying investors’ increasing interests in the calculation of fees and expenses with the SEC’s proposed rule changes and internal risk assessments—and the results are still unknown.

CRAIN’S: How does the prospect of a recession impact the short- and long-term investment planning for advisers dealing with more defined investment mandates?

JACLYN GRODIN AND ALLISON SHERRIER: With the uncertain prospect of a recession looming, private equity firms need to be agile and watch for opportunities. In general, private equity firms typically fare better than public markets in a recession. They have the option to hold a long-term investment until the value improves, although some investors may not want to wait for returns and the fund may have exit requirements. In addition, when traditional lending institutions tend to shy away from risky investments in an economic downturn, private equity funds can take advantage of the lack of bank funding, in order to invest—on favorable terms—in companies that need a capital infusion in the short-term.

CRAIN'S: In the face of growing competition in the private fund space, how are funds and advisers differentiating themselves to attract increasingly diligent investors, both on the individual and institutional side?

JACLYN GRODIN AND ALLISON SHERRIER: Right now, advisers are trying to find deals that make sense ahead of a likely recession, while pricing those deals at multiples that reflect the reality of the current, volatile market. That's not an easy task, and advisers are becoming more creative in identifying value across the post-pandemic economy in sectors they may not have considered before. Likewise, investors on the institutional and individual sides are leaning into diligence in a more thoughtful and demanding way than before, requiring advisers across the private equity landscape to respond with a greater understanding of the motivation behind the request—and the risk that investors may abandon an investment opportunity if they find more firm and adviser engagement elsewhere.

CRAIN'S: From the changing economic pressures to increased transparency requirements, what are the greatest challenges private equity firms are currently facing when raising a new fund?

JACLYN GRODIN AND ALLISON SHERRIER: While private equity firms are juggling the changing regulatory regime and the shifting economy, the biggest challenge remains predicting and navigating the economic uncertainties. The increased transparency requirements will have an increased administrative burden, but most established private equity firms already have robust reporting policies in place. However, inflation and higher interest rates will decrease the projected returns to investors, while simultaneously making it more difficult to obtain debt financing. As a result, the major challenge for private equity firms who are raising a new fund is determining which investments will most likely provide steady returns, and making the investment returns worthwhile for investors.

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