alterDomus*

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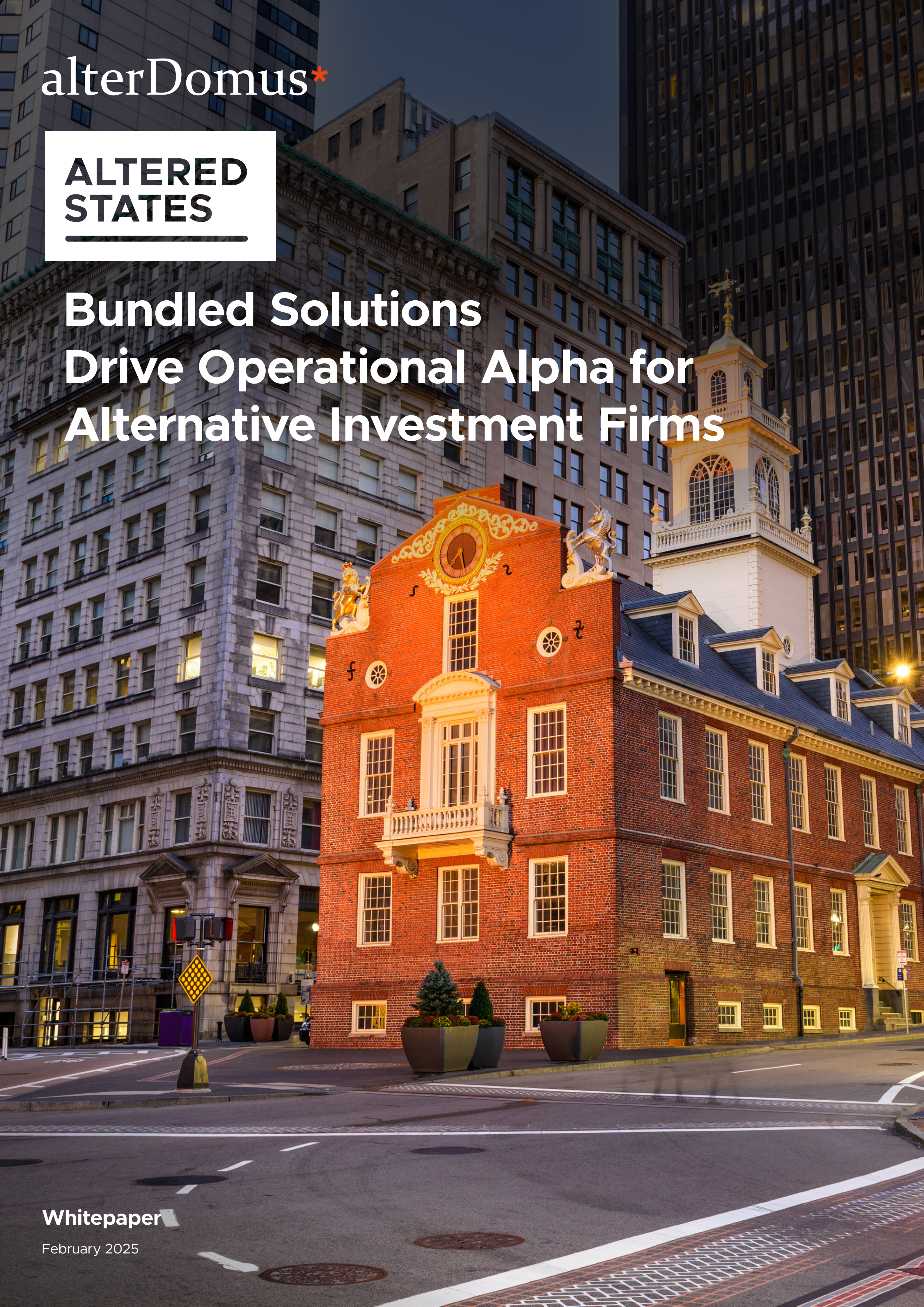
Bundled Solutions Drive Operational Alpha for Alternative Investment Firms



Whitepaper

February 2025

Executive Summary

> "Alternative investment managers are navigating an increasingly complex, high stakes operational landscape. Managing human capital, growing regulation, and rapid technological change is driving managers' business needs. The demand for what we call operational alpha has never been greater."

At one time, managers could choose to build and evolve in-house operational functions or partner with a specialist fund administrator. Now, the trend is clear: managers favor comprehensive, outsourced bundled solutions over piecemeal offerings, seeking partnerships that deliver efficiency, scalability, and strategic alignment.

Meeting the changing needs of the market requires a continuously evolving understanding of client needs. As such, this whitepaper explores the landscape of operational model efficiency and what is needed to drive operational alpha. It is centered on a selection of insights from a far-ranging McKinsey & Co. survey commissioned by Alter Domus, which captures fund manager views, concerns, and preferences about their evolving business operations. The quantitative analysis in this whitepaper is complemented by an interview with Alter Domus' COO, Michael Janiszewski, offering his firsthand insights on industry trends and developments.

Global Perspectives: Who We Surveyed

The findings in this whitepaper are grounded in insights from the McKinsey & Co. survey of 192 professionals utilizing Financial Advisor (FA) and/or Debt Capital Management (DCM) services. These respondents represent a diverse cross-section of industries, including alternative investment firms (32%), asset management (25%), banking (22%), and credit unions and private loan providers (21%). The funds surveyed range in size from under $250 million to over $5 billion, covering a broad spectrum of perspectives.

The survey captured input from high-level decision-makers, with 20% serving as CFOs or senior financial executives, 17% as CTOs or senior technology executives, and 16% as CEOs. Other roles included portfolio, fund, or investment managers (10%), COOs or senior operations executives (10%), and a range of additional leadership positions (27%).

This diverse pool of respondents has resulted in a dataset that provides a comprehensive lens for exploring trends shaping fund administration. The insights reflect the collective experiences of industry leaders across North America, Europe and APAC, bringing global relevance to the analysis.

The Complexity of Scaling Alternative Investments

As alternative investment managers expand into new jurisdictions, asset classes, and strategies, they face mounting operational challenges. These include human capital pressures, technological evolution, regulatory scrutiny, and heightened investor needs.

One major hurdle is human capital. Retaining and developing skilled teams capable of managing diverse and increasingly complex back-office functions in-house is a significant challenge. Additionally, rapid technological advances require managers to continuously upgrade and integrate additional functionality into their systems. What's more, as data volumes, product suites and operational complexity increase, this task becomes more time consuming and costly.

Regulatory compliance presents further hurdles. Significant variance in legislation from different jurisdictions adds to complexity. Indeed, the proliferation of compliance and reporting standards across jurisdictions make it increasingly difficult for managers to keep pace with only in-house capabilities.

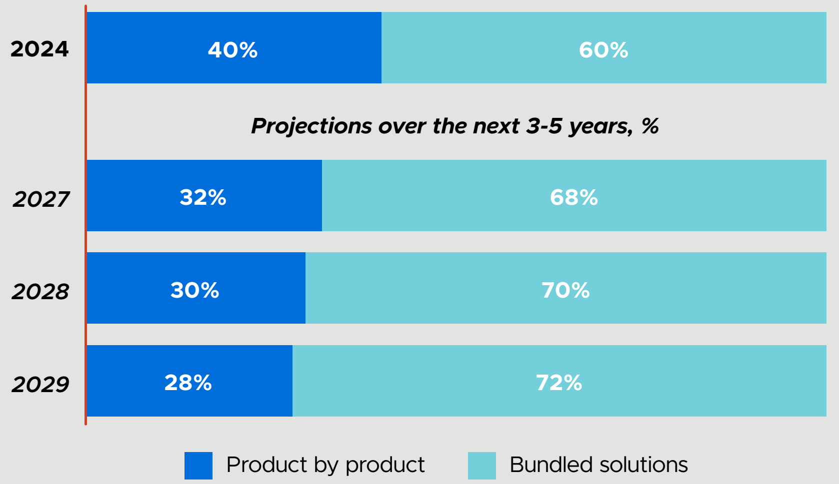
Investors' need for transparency further complicates the operational landscape. The delivery of fund information needs to be timely, accurate and clearly sourced. To handle this, managers must offer robust processes that provide the data and reports efficiently with a consistent cadence.

Pressure from investors in these areas is leading many alternative investment managers to weigh the costs and feasibility of maintaining operations in-house. As the operational costs of inefficiency rise, outsourcing is increasingly being adopted to manage costs and scale effectively.

Finding the Right Partner

Cost efficiency, reduced complexity and improved reporting are the clear benefits of outsourcing. Increasingly, comprehensive bundled solutions are the most popular. Our research highlights this trend, revealing that 60% of GPs currently prefer bundled solutions - a figure expected to rise to 72% within the next 3–5 years. However, geographical nuances persist. In Europe, best-of-breed solutions are preferred over a one-stop-shop offering when selecting a fund administration service provider for future engagements. In contrast, North American respondents lean toward one-stop-shop offerings. That said, these differences in preference are relatively minor.

Figure 1:
Growth in Preference for Bundled Fund Administration Solutions



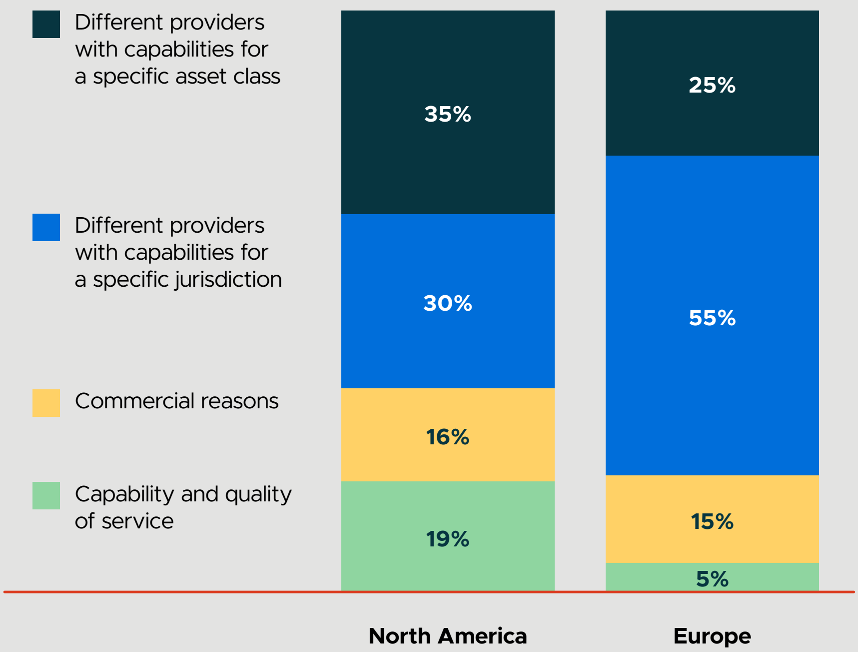
Source: Alter Domus customer survey, McKinsey

Fund managers know that not all fund administrators are created equal. Solutions are often fragmented, adaptability is limited, and service quality varies. While some providers excel in specific areas, they often lack the breadth and depth of operational service capability to give true holistic expertise. Meanwhile, others struggle to accommodate complex strategies, instead offering rigid solutions that fail to align with managers' requirements.

In contrast, an effective operations partner is able to excel across an increasing number of functions. A vital part of this involves bringing deep jurisdictional expertise, asset class knowledge and the ability to support an expanding array of investment vehicles such as NAV loans and secondaries. These capabilities create a powerful combination which can drive superior value in the provision of solutions.

Many managers are increasingly seeking customized solutions to support operations across asset classes and geographies, as priorities shift depending on the region and type of asset. For instance, in Europe, asset class expertise ranks as the most important factor for GPs, followed by core technology capabilities, with price being the least important. Conversely, in North America, customer service is paramount, especially in real estate and private debt strategies (Figure 2).

Figure 2:
Fund Administrator Selection Criteria by Region and Asset Class



Source: Alter Domus customer survey, McKinsey

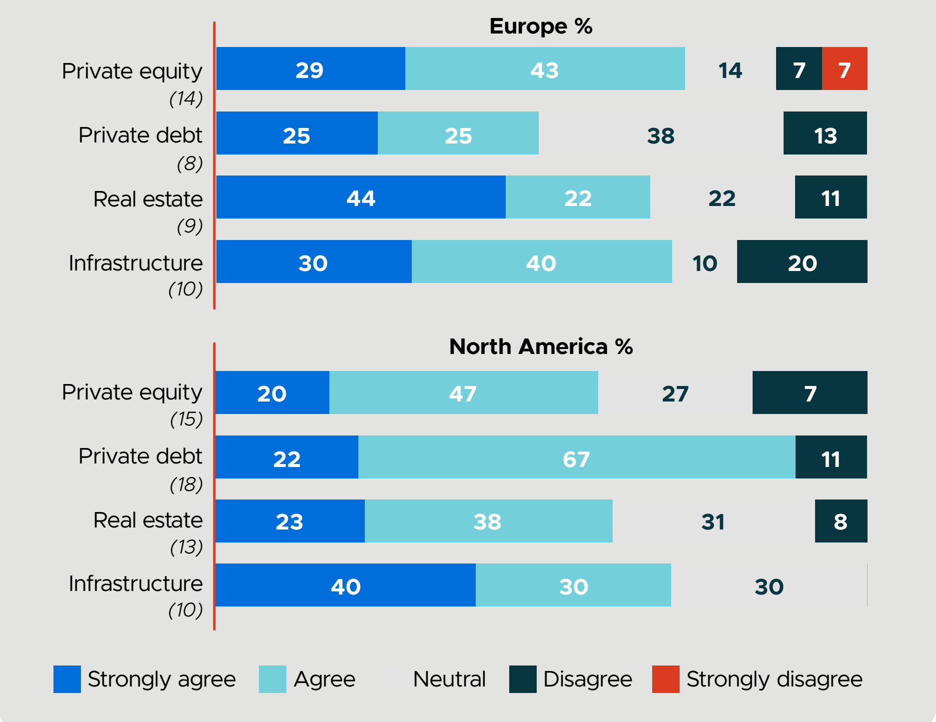
These regional preferences underscore the importance of selecting a fund administrator that delivers both superior service and deep expertise across jurisdictions and strategies. As with any industry, some offerings lack consistency in service quality, particularly across different jurisdictions or markets. This inconsistency can hinder managers' ability to scale effectively and meet the evolving demands of investors and regulatory bodies.

Why Bundling Works

Our report further demonstrates that by bundling services, managers set themselves up for some considerable gains. Operational efficiency, knowledge share and integrated service delivery underpins the benefits fund managers can derive from bundling services. In turn, this fosters a true strategic partnership anchored by a fund administrator's operating platform and service mindset focused on functional and holistic alignment.

This is why over 50% of GPs across all segments – private equity, real estate, infrastructure, and private debt - are actively considering when to outsource additional functions to their fund administrators. The opportunity for alternative fund managers is to push operational alpha by working with an administrator that can handle increasing functional complexity, scalable service iteration and offer a close partnership. (Figure 3).

Figure 3:
GP Willingness to Outsource Additional Functions to Existing Fund Administrators



For these reasons, managers will increasingly seek out administration service providers that integrate seamlessly into their broader operational ecosystem and through this alignment generate value over time. Moreover, the use of bundling services allows alternatives managers to gain value-added insights that extend beyond routine administration and help them scale their operations and improve both services and reporting for clients.

Michael Janiszewski
Chief Operating Officer,
Alter Domus

Insights from the COO: A Q&A

How do COOs at GPs decide whether to outsource?

Smaller GPs may embrace outsourcing to avoid building their own operations, while larger GPs may weigh the cost-effectiveness of internal and external solutions. However, COOs typically align on a consistent set of considerations when deciding to outsource:

- Expertise and specialization: How do internal capabilities for expertise in complex operations compare to what may be available with a partner? How will needs change over time, and what is the best way for the firm to keep up? Working with a partner can provide access to difficult or costly-to-build capabilities.
- Control and customization: Some GPs prefer in-house operations to maintain full control over sensitive data and processes. However, customized capabilities are increasingly available offering greater use of digital technologies, such as dashboarding, workflows, and automation, which allow for control to be effectively maintained.
- Technology and data management: Investor reporting, compliance, and analytics, along with advanced platforms, automation, and integrated systems, are hot topics for the COO's technology agenda. Weighing the in-house appetite for investments and maintenance of these technology platforms versus working with a partner is a key consideration.
- Operational efficiency, scale, and cost: Can internal operations scale to meet the demands of fund growth, including transaction volumes or expansion into new asset classes? How does this compare to a partner's ability to do this efficiently? How does the cost of maintaining internal staff, technology, and infrastructure compare to the benefit of market pricing and the ability to "variabilize" these costs?
- Regulatory compliance and risk management: Running complex operations in-house requires strong risk controls and compliance safeguards. Investing in these versus working with a provider who specializes in risk and compliance solutions must be considered.

What do fund admins need to do to better understand their client's unique business challenges and opportunities?

Fund administrators need to anticipate and invest ahead of their clients' needs wherever possible. It is the fund administrator's responsibility to stay close to the market in terms of industry innovation, technology trends, and regulation. Bringing this perspective and listening to clients is at the heart of the conversations we have every day.

How can a fund administrator evolve to address these challenges?

Quite simply, spend more time in the market with clients and regulators to understand where the industry is headed. Then invest in operating models, including processes, technology, and a global servicing footprint. For a fund administrator this means solution development that is more global, incorporates multiple asset classes, operates across multiple regulatory jurisdictions, and supports both GP and LP demands for timely transparent information. Doing all this helps Alter Domus deliver value through highly consultative client service.

What's next for the industry? (tech, consolidation, regulatory change, etc.)

Technology innovation looms large as it provides significant efficiencies and improves decision-making and client experience. Clearly, data management, automation, and machine learning/AI are game changers for fund management and client service. It's exciting to see how many technologies are starting to incorporate solutions for alternative assets.

Growth will take several forms: large investment firms will continue to expand into new capabilities, while consolidating the market; while growing firms will seek to "go global" with their value propositions in search of new opportunities. Innovation in private capital products and distribution, including increased liquidity options and retailization/semi-liquid vehicles, will also be significant.

Regulation will remain dynamic. In the US, we expect a better antitrust environment for dealmaking. In the EU, there is continued interest in enhancing AIFMD regulations focused on ESG, liquidity management, and leverage reporting. As well, the OECD's global tax initiatives are expected to bring cross-border tax planning, and restrictions on profit repatriation will introduce new challenges for global private equity firms.
AIFMD will also continue to set a framework for operations of open-ended structures, as seen in provisions for loan-originating AIFs.