The Rise of GP Stakes: From Niche to Mainstream

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What factors contributed to the rise of GP stakes as a mainstream private equity strategy?

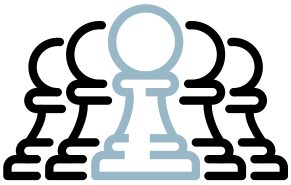
GP stakes emerged as a dedicated institutional fund strategy as a byproduct of the rapid growth in assets under management across private capital firms after the Global Financial Crisis (GFC).

GP stakes have a much longer history dating back to the 1980s, but transactions were infrequent and largely strategic in nature. For example, certain large asset owners pursued ownership interests in select GPs to create more aligned partnerships, sharing in the economic value created in part by their own substantial commitments and securing preferred access to future investment opportunities (e.g., CalPERS acquired a stake in The Carlyle Group in 2001). For the most part, however, there was no pressing financial catalyst for private markets GPs to pursue such a transaction. This changed with the surge in investor interest in private markets exposure after the GFC. To accommodate increased demand from existing and new investors and meet increased expectations around GP commitment percentages, many of these firms required growth capital to supplement cash flows generated by management fee profitability and carried interest. GP stakes transactions offered these firms a compelling means to inject additional balance sheet capital to fund larger GP commitments, make additional hires, invest in organizational infrastructure, and otherwise accelerate firm growth timelines in an aligned fashion.

While the secular growth of private markets created structural demand for growth capital solutions, the GP stakes market opportunity could not fully take off until the value proposition to investors, as potential limited partners in GP stakes funds and as limited partners in GPs selling a stake, was understood. With market education and the benefit of time, many investors now recognize the merits of investing in GP stakes, which offer diversified private markets exposure and can provide private equity return multiples generated through a combination of yield and capital appreciation. Investors also appreciate why successful GPs with substantial growth opportunities would consider selling a stake, and that such a sale does not adversely impact a given GP's funds' limited partners. Instead, a GP stake sale can benefit current and future fund limited partners by augmenting a GP's existing capabilities and building a more long-term durable firm.

How can GP stakes transactions create a more aligned and durable business?

Since a GP's enterprise value is ultimately a function of current and future capital commitments, which provide a combination of guaranteed cash flow from management fees and contingent cash flow from carried interest, a GP stakes investor is necessarily focused on preserving the conditions necessary to support sustained investment performance. After all, LP appetite for a GP's future fund offerings will only reasonably remain in place if the GP continues to provide attractive performance.

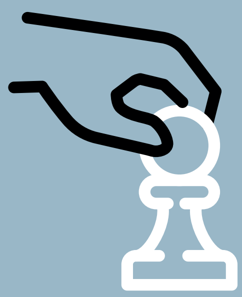


First and foremost, the nature of the transaction proceeds and the composition of the economic interest sold often ensures that a GP's alignment to fund performance increases after the sale. Transaction catalysts can vary but the primary driver is a need for additional capital to invest alongside LPs in the form of GP commitments. By selling a minority stake, a GP transforms an ownership interest in future cash flows including management fees (which are aligned to growth invariant of performance) in exchange for upfront capital to increase GP commitments (which are aligned to performance) on both an absolute and percentage basis in current or future funds. Importantly, the GP also continues to own the vast majority of carried interest; transactions often explicitly contemplate a carry compensation pool for non-equity holders to preserve financial motivations of the broader team. It is thus unsurprising that early evidence published in academic research and elsewhere suggests that GPs that have sold a stake have continued to outperform relative to a cohort of peers and public market equivalent exposures[1].

Beyond structuring transactions to maintain incentives and reinforce alignment to performance, GP stakes investors negotiate a series of other protections and terms designed to foster a long-term durable business; thus, firms that have sold a GP stake are often stronger and better positioned than firms that have not sold a GP stake. Key individuals and successors are subject to a combination of restrictive covenants (e.g., non-competes and non-solicits) and long-term service and/or employment agreements; these protections benefit a GP's limited partners too and often were not in place before the GP sold a stake. Moreover, GP stakes investors focus on succession planning and equitization of the next generation talent to instill an ownership culture and increase the likelihood that the producers of tomorrow will remain with the firm rather than join larger competitors or start their own firms. In addition to fresh financial motivations, the next generation talent often benefits from increased responsibilities and career development opportunities that can naturally follow as the GP scales. Lastly, a GP stakes investor can enhance a GP's competitive positioning by offering market intelligence insights and additional resources while leaving the GP with full control and decision-making autonomy to preserve the entrepreneurial and investment cultures that made the GP successful.

1 Sources: Gahng, Minmo & Jackson, Blake. "Selling Private Equity Fees" (May 16, 2024); Pitchbook. "Manager Behavior After Selling a Stake" (June 8, 2021); Billias, Alex & Lerner, Josh & Jeng, Leslie. "GP Stakes: A New Asset Class or a Dead End", State Street Private Equity Insights (Q1 2024).

How do GP stakes compare to other private equity strategies from a liquidity perspective?



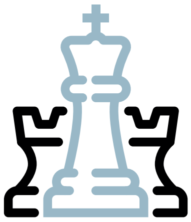
GP stakes offer investors a combination of current income and capital appreciation, which can be monetized through traditional exit avenues.

The current income component is well understood by most, especially by investors that have directly experienced the immediate and regular cash flow distributions linked to participation in a GP's management fee profits, carried interest, and balance sheet income.

The exit, on the other hand, has been an open question for some. The first private equity firms pursuing GP stakes on a programmatic basis invested out of permanent capital vehicles, and could only discuss exits in concept, which reinforced the skeptical viewpoint that ownership interests in alternative asset management firms might prove to be inherently more illiquid than an ownership interest in any other private company. In reality, a GP stake is a transferable security that can be financed or sold like an interest in any other company. GP stakes investors with long investment horizons may elect to hold positions indefinitely and compound return through ongoing and growing yield, but positions can be, have been, and will be sold.

Many industry participants, including Azimut, have experienced successful exits. Liquidity proof points include single asset sales, multi-asset sales, portfolio strip sales, and initial public offerings. Secondary sales have involved both financial and strategic buyers and may become increasingly common. Moreover, the prospect of tokenization and general industry trends such as consolidation and the rapid expansion of secondaries funds augur well for future exits. High performing and scaling lower middle market and middle market firms will be natural acquisition targets for strategics seeking to drive asset growth and expand investment capabilities to better compete. Additionally, intermediate liquidity solutions including dividend recapitalizations and securitizations provide a means to accelerate investor distributions in advance of a full exit; securitizations of GP stake portfolios have garnered interest from insurance companies and other yield-focused asset owners, and a variety of alternative lenders provide advances against the cash flows of a single GP stake. In short, a diverse range of liquidity paths already exist, and the industry will undoubtedly continue to innovate to provide additional solutions.

Where is the GP stakes market headed next and where do the best opportunities exist?



At Azimut, we focus on the lower middle market which we define to be GPs with $500 million to $3 billion in fee-paying assets under management. We believe this segment of the market has the most favorable supply and demand dynamics, the most aligned transaction structures, and the most liquidity options. That said, opportunities exist to provide capital and value creation to GPs at different stages of development, and in aggregate, the market remains capital constrained.

GP stakes will likely continue to command interest from investors and GPs. For GPs, the need for a financial and strategic partner is stronger than ever, in particular in the lower middle market and middle market. Against the backdrop of an increasingly challenging fundraising environment and the reality that limited partners are seeking to consolidate relationships, these GPs may seek the capital and guidance provided by a GP stakes investor to more effectively compete. For investors, GP stakes offer a differentiated return profile relative to other private equity strategies with strong defensive characteristics. While most private equity strategies generate returns exclusively from capital appreciation, GP stakes also provide steady income from management fee profitability and carried interest. As an ancillary benefit, investors gain a privileged lens into a portfolio of successful GPs that have withstood substantial diligence that they may consider making an allocation to in the future. GP stakes have become increasingly common in investor portfolios as a result; according to a survey conducted by McKinsey, approximately 43% of institutional LPs invest in GP stakes funds today[2]. Further demand may come from new investor channels. For example, GP stakes provide a natural access point for the private wealth channel or other investors looking to build initial private equity allocations as a GP stakes fund offers broad exposure through a single investment. Through a single GP stake an investor receives exposure to older funds which are actively investing or in harvest mode and funds that will be launched in the future. A portfolio of GP stakes provides diversification across geographies, asset classes, sectors, strategies, and vintages.

Looking ahead, several trends will drive new investment opportunities in GP stakes. Strategic consolidation activity is likely to accelerate as larger asset managers look to acquire proven investment platforms, particularly in high-growth areas like private credit and infrastructure. Geographic expansion also presents compelling opportunities as GP stakes strategies gain traction in European and Asian markets, where many successful regional managers have not yet engaged with GP stakes capital. We also expect increasing specialization within the strategy. For example, some funds may focus exclusively on private credit platforms to meet institutional demand for more targeted exposure. The market's maturation will likely drive the emergence of dedicated GP stakes secondaries funds as well, providing liquidity solutions tailored specifically to this asset class. These developments will create a more diverse opportunity set for GP stakes investors and address the evolving needs of institutional allocators and general partners at different stages of development.

2 Sources: Edlich, Alexander & Croke, Christopher & Dahlqvist, Fredrik & Teichner, Warren. "Global Private Markets Report 2025: Private equity emerging from the fog" (February 13, 2025). McKinsey & Company.