TOWARDS A POST-JENSENIAN PRIVATE EQUITY PARADIGM: THE AGENCY COSTS OF MULTI-PRODUCT SUITES

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ABSTRACT

In 1989, the late Professor Michael C. Jensen rationalized private equity buyouts as a golden bullet for the "agency costs" problem in widely held companies. However, over the course of the succeeding three and a half decades, the private equity sector has changed almost beyond recognition. Consequently, a world which in the 1980s was heavily U.S.-centric and characterized by relatively small-scale, boutique finance firms has morphed into a globalized arena dominated by very large, multi-divisional, and bureaucratically complex financial conglomerates. Notwithstanding these seismic contextual changes, the Jensenian model of private equity remains the central theoretical paradigm through which private equity buyouts are understood within law and finance scholarship.

This Article tracks the evolution of large-scale private equity firms over the past half-century, from their original guise as monoline and slim boutiques to their contemporary status as sophisticated multi-product suites. It highlights the conflict between General Partner and Limited Partner interests where fee streams become a more attractive revenue source for private equity firms than performance-based carry. It argues that this conflict encourages private equity firms to adopt an asset-gathering mentality at the expense of maximizing fund capital gains, which is a critical new agency costs problem for the sector at large. Accordingly, this Article posits that a critical reappraisal of the descriptive relevance of the Jensenian theory of private equity is now long overdue, to enable it to take account of this changed organizational context.

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The Authors would like to dedicate this Article to the memory of the late Professor Michael C. Jensen, who passed away on April 2, 2024 following the completion of the first draft of this Article. The Authors are indebted to Professor Jensen's scholarship not just for informing the core of this Article, but also on account of its pivotal influence on modern corporate governance and private equity scholarship generally, including much of the Authors' own thinking on these topics. His recent passing leaves a significant and unfillable gap in the global social-scientific academy.

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INTRODUCTION

Private equity ("P.E.") is one of the most privately lucrative and publicly controversial aspects of global business and finance.[1] Few areas of the modern corporate world elicit a greater degree of divergent opinion amongst commentators.[2]

Traditionally, P.E. was regarded by many as a marginal, technical, and opaque form of corporate finance, with few discernible implications for the real economy outside the offices of New York City financial boutiques. However, in recent decades, P.E.'s public profile has expanded considerably,[3] and the subject has on occasion even garnered popular newspaper coverage.[4] P.E.'s enhanced salience is partly due to the sheer economic scale of the sector, with the aggregate value of private market assets under management recently estimated at a staggering $13.1 trillion.[5] It is also due to the P.E. sector's increasing importance to the lives of ordinary working citizens today, with P.E.-owned portfolio companies providing almost twelve million jobs today in the United States alone while, at the same time, generating 6.5% of the country's gross domestic product.[6]

Unfortunately, P.E. has also become synonymous in the public consciousness with many of the most unpopular aspects of twenty-first century capitalist society,[7]

1. *See* William Cohan, *The Deals That Show How Lucrative Private Equity Can Be*, FIN. TIMES (Dec. 16, 2023), https://perma.cc/PZ6T-NHRZ; Chris Cumming, *Private-Equity Pay Rises After Blowout Year for Deals, Fundraising*, WALL ST. J. (Sept. 15, 2022), https://perma.cc/EM6A-PDSZ.
2. For examples of such starkly polar views, see Megha Bansal Rizoli, *Private Equity Holds the Key to Creating Quality Jobs for Millions*, WORLD ECON. F. (Jan. 10, 2024), https://perma.cc/Y8YT-EZ3P; Brendan Ballou, *Private Equity Is Gutting America – and Getting Away With It*, N.Y. TIMES (Apr. 28, 2023), https://perma.cc/BMS7-ALZY.
3. In particular, just before the onset of the 2008 global financial crisis, it was reported that private equity in Europe had grown "from almost nothing in the 1980s to levels that are not very different from those of the U.S." Viral V. Acharya et al., *Private Equity: Boom and Bust?*, 19 J. APPLIED CORP. FIN. 44, 44 (2007).
4. *See, e.g.*, Aliya Sabharwal, *Opinion: Wall Street Predators Destroyed Toys 'R' Us. Now They're Coming for Simon & Schuster*, L.A. TIMES (Aug. 11, 2023), https://perma.cc/8YZM-5VA9.
5. *McKinsey Global Private Markets Review 2024: Private Markets in a Slower Era*, MCKINSEY & CO. (Mar. 28, 2024), https://perma.cc/GZ7Z-K94W.
6. Rizoli, *supra* note 2; *New EY Report – Private Equity Fuels Job Growth, High Wages, and Small Businesses*, AM. INV. COUNCIL (Apr. 24, 2023), https://perma.cc/KG72-PK8Y.
7. Chapman and Klein have observed how "[c]ritics argue that the PE sector's recent problems are the logical outcome of Wall Street excesses and faddish investing, ratifying their long-held belief that this sector serves mainly to transfer wealth 'from Main Street to Wall Street.'" As the authors further note, this is despite the fact that "our knowledge of the nature and effects of private-equity investment is at best fragmentary and incomplete." John L. Chapman & Peter G. Klein, *Value Creation in Middle-Market Buyouts: A Transaction-Level Analysis* 3 (Contracting & Orgs. Rsch. Inst., Working Paper No. 2009-01, 2009), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1372381.

including allegedly excessive compensation awards, rapacious corporate asset-stripping projects, shrewd tax avoidance schemes, and market-destabilizing borrowing practices.[8] Meanwhile, a variety of commentators, including labor unions, politicians, journalists, and even some P.E. practitioners themselves, have at times lined up to criticize the sector.[9]

At the other extreme of the debate, however, P.E. has been lauded as a transformative force for good[10] that has the capacity to reinvigorate modern corporate capitalism.[11] Above all, from a governance perspective, P.E. is commonly seen as a much more engaged and committed form of corporate ownership[12] compared to the relatively costly, distant, and intermittent methods of oversight associated with many institutional investors in publicly traded corporations.[13]

The perceived positive impacts of P.E. ownership have also been noted outside the public company space. Within the private or non-traded firm context, P.E. ownership is frequently presented as a more professionalized and, correspondingly, less idiosyncratic form of proprietary influence than that associated with founder or family controllers.[14] Moreover, from an investor's point of view (and notwithstanding the often conflicting and inconclusive empirical evidence on the issue[15]), P.E. funds are

8. *See*, *e.g.*, Ballou, *supra* note 2.

9. *See*, *e.g.*, Rogé Karma, *The Secretive Industry Devouring the U.S. Economy*, ATL. (Oct. 30, 2023), https://perma.cc/BYX3-XF79; Kerry Capell & Gail Edmondson, *A Backlash Against Private Equity*, BLOOMBERG (Mar. 11, 2007), https://perma.cc/6PSQ-A8YU; Peter Smith, *'Locusts' Swarm to Germany in Effort to Improve Image*, FIN. TIMES (Feb. 19, 2006), https://perma.cc/MW7X-P2BN. Curiously, however, empirical evidence has tended to cast doubt on the popular adage that P.E. ownership necessarily leads to net reductions in employment within portfolio companies. *See*, *e.g.*, Steven J. Davis et al., *Private Equity and Employment* (Nat'l Bureau of Econ. Rsch., Working Paper No. 17399, 2011).

10. For instance, in the case of P.E. buyouts of formerly publicly traded or state-owned enterprises, it has been claimed that "significant entrepreneurial progress is made not through managerial incentives alone but from a cognitive shift from a managerial to an entrepreneurial mindset." Mike Wright et al., *Entrepreneurial Growth Through Privatization: The Upside of Management Buyouts*, 25 ACAD. MGMT. REV. 591, 599 (2000).

11. *See*, *e.g.*, Saqib Bhatti, *Private Equity Is Not the Enemy – It's What Powers Businesses to Be a Force for Good*, CITY A.M. (Nov. 2, 2020), https://perma.cc/UU2L-NR6G.

12. *See*, *e.g.*, Erkki Nikoskelainen & Mike Wright, *The Impact of Corporate Governance Mechanisms on Value Increase in Leveraged Buyouts*, 13 J. CORP. FIN. 511 (2007); Douglas Cumming et al., *Private Equity, Leveraged Buyouts and Governance*, 13 J. CORP. FIN. 439 (2007).

13. *See generally* Mike Wright et al., *Private Equity and Corporate Governance: Retrospect and Prospect*, 17 CORP. GOV.: INT. REV. 353 (2009).

14. On the notion of idiosyncratic business ownership generally, see Zohar Goshen & Assaf Hamdani, *Corporate Control and Idiosyncratic Vision*, 125 YALE L. J. 560 (2016).

15. *See*, *e.g.*, Ludovic Phalippou & Oliver Gottschalg, *The Performance of Private Equity Funds*, 22 REV. FIN. STUD. 1747 (2009); Robert S. Harris et al., *Private Equity Performance: What Do We Know?*, 69 J. FIN. 1851 (2014); Raviraj Karmvir Gohil & Vijay Vyas, *Private Equity Performance: A Literature Review*, 19 J. PRIV. EQUITY 76 (2016); Gregory W. Brown & Steven N. Kaplan, *Have Private Equity Returns Really Declined?*, 22 J. PRIV. EQUITY 11 (2019);

widely regarded as a source of consistently superior returns relative to many other alternative investment outlets, especially public stock markets. Indeed, because of the above factors, the number of listed companies has reduced significantly since the early 2000s.[16]

In its literal sense, the term "private equity" refers to any investment in the equity or risk capital of a business where the share of capital purchased is relatively large and illiquid (or of limited liquidity), and hence not easily tradable on a public investment market. The term is thus potentially applicable to different kinds of investment including, inter alia, venture capital and rescue capital. Most commonly today, though, the term "private equity" is used specifically in reference to leveraged buyout ("LBO") transactions, whereby specially constituted investment funds purchase controlling stakes in existing traded or untraded companies, in effect by borrowing against the target firm's assets and/or projected future cash flows.[17]

On the corporate (or "demand") side of the P.E. capital market, the purpose of the above arrangement is normally to restructure, reorganize, or further grow the acquired company's business. This is with a view to re-selling the company within a few years through a public stock offering or to another private buyer. In the latter event, the putative buyer could be a larger and/or more established industry competitor, or even another P.E. fund. Following a limited period under P.E. ownership and control (typically three to five years), the ultimate expectation for the portfolio company is that the entity would repay the debts owed from its initial acquisition while also realizing a significant financial return for the P.E. firm (known as the General Partner or "GP") and its external fund investors (known as Limited Partners or "LPs"). This return usually originates from the new controller's strategic use of leverage or gearing (i.e., debt) based on the portfolio company's excess cash reserves,[18] coupled with operational improvements effected within its underlying businesses.[19]

Absolutely critical to this arrangement is the existence of an effective GP compensation structure, by virtue of which the lead P.E. firm and its assigned partners

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Ludovic Phalippou, *An Inconvenient Fact: Private Equity Returns and the Billionaire Factory*, 30 J. INVESTING 11 (2020); Peter Morris & Ludovic Phalippou, *Thirty Years After Jensen's Prediction: Is Private Equity a Superior Form of Ownership?*, 36 OXFORD REV. ECON. POL'Y 291 (2020).

16. On this trend, see generally Alexander Ljungqvist et al., *Private Equity's Unintended Dark Side: On the Economic Consequences of Excessive Delistings*, (Nat'l Bureau of Econ. Rsch., Working Paper No. 21909, 2016), https://www.nber.org/papers/w21909; Susan Chaplinsky & Latha Ramchand, *What Drives Delistings of Foreign Firms from U.S. Exchanges?* 22 J. INT'L. FIN. MKT. INSTS. & MONEY 1126 (2012).

17. Steven N. Kaplan & Per Strömberg, *Leveraged Buyouts and Private Equity*, 23 J. ECON. PERSPS. 121, 121 (2009).

18. Adam Caines et al., *Debt Finance*, *in* PRIVATE EQUITY: A TRANSACTIONAL ANALYSIS 153, 153 (Chris Hale ed., 2024).

19. ORIT GADIESH & HUGH MACARTHUR, LESSONS FROM PRIVATE EQUITY ANY COMPANY CAN USE 14 (2008).

and/or associates are given compelling incentives to generate attractive LP returns.[20] Hence the paramount importance of carried interest (or "carry"), by which the GP is typically entitled to a twenty percent share of absolute returns generated over the assigned period, but only after surpassing the (annually-compounded) eight percent "hurdle" rate of return.[21] This emphasis on rewarding capital gains in the underlying equity value of the relevant portfolio companies and funds makes P.E. incentive-compensation much more powerful than traditional investment fund manager fee structures, which are calculated according to the aggregate value of assets under management ("AUM") irrespective of absolute returns.[22] Traditional fund manager compensation practices have tended to incentivize the accumulation of AUM often at the expense of sub-optimal rates of return on those assets for the relevant funds' beneficiaries.[23] A key attraction of P.E. has been its perceived proclivity to avoid or at least significantly mitigate these problematic conflicts of interest.

On the investor (or "supply") side of the P.E. capital market, buyouts are typically implemented via temporary, time-limited funds established as limited partnerships. These P.E. funds automatically liquidate on their assigned termination date (typically ten years from the time of formation), thereby automatically putting pressure on GPs to generate near-term, realizable cash returns for their LPs (and, in turn, themselves) on any investments made within that time. The fund LPs, meanwhile, will normally be an assortment of sophisticated institutional investors such as pension funds, mutuals, insurers, hedge funds, sovereign wealth funds, and family offices, each of whom will usually take a large and illiquid position in the relevant P.E. fund and thus have significant indirect exposure to the fortunes (or misfortunes) of each of that fund's investee portfolio companies.

In addition to capturing the public imagination in the form of well-known Hollywood movies and popular books,[24] P.E. has, at least in the past, also been a pertinent subject for academic theorizing. In 1989, the late Harvard professor and financial economist Michael C. Jensen predicted—albeit in a deliberately exaggerated manner—the "eclipse of the public corporation" at the hands of the then-rapidly

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20. Paul Gompers et al., *What Do Private Equity Firms Say They Do?*, 121 J. FIN. ECON. 449, 450 (2016).

21. *See infra* note 94 and accompanying text; Stephen Fraidin & Meredith Foster, *The Evolution of Private Equity and the Change in General Partner Compensation Terms in the 1980s*, 24 FORDHAM J. CORP. & FIN. L. 321, 329 (2019).

22. *See infra* note 95 and accompanying text.

23. This has especially been the case for diversified mutual funds, the vast majority of which "charge fees based on a flat percentage of the fund's assets under management" and therefore "provide only small direct incentives to engage in costly activism." Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021, 1051 (2007).

24. *See*, *e.g.*, WALL STREET (20th Century Fox 1987); BRYAN BURROUGH & JOHN HELYAR, BARBARIANS AT THE GATE: THE FALL OF RJR NABISCO (1989).

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growing U.S. P.E. sector.[25] In so doing, Jensen provided what was, and largely still is today, the dominant intellectual rationalization of P.E. as a market-institutional phenomenon. Jensen presented P.E. buyouts as a golden bullet for the "agency costs" problem[26] in widely held companies, which he had first expounded over a decade earlier in his landmark 1976 article with William Meckling on the topic.[27]

Both in this article and in a subsequent, more corporate-specific piece co-authored with Eugene Fama, [28] Jensen demonstrated how, despite dispersed minority shareholders struggling to exert control over salaried corporate managers in public companies, there were nonetheless an array of potential market mechanisms pressuring managers to prioritize shareholders' interests over other organizational objectives. Although P.E. buyouts (or LBOs as they were known in the 1980s) did not initially figure into this institutional landscape, Jensen succeeded in slotting them into the conceptual frame a decade later in two epochal articles published around the time of the late-1980s' buyout boom period.[29]

However, over the course of the ensuing three and a half decades, the P.E. sector has changed almost beyond recognition. Consequently, a world which in the 1980s was heavily U.S.-centric and characterized by relatively small-scale "boutique" finance firms has morphed into a globalized arena dominated by very large, multi-divisional, and bureaucratically complex financial conglomerates, which, prima facie at least, are largely indistinguishable from their more established investment banking and

25. *See* Michael C. Jensen, *Eclipse of the Public Corporation*, HARV. BUS. REV. 1, 1-2 (1989) [hereinafter Jensen, *Eclipse*].

26. Jensen has described agency costs theory succinctly as "a major part of the economics literature" premised on the notion that "[c]orporate managers are the agents of shareholders, a relationship fraught with conflicting interests." Michael C. Jensen, *Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers*, 76 AM. ECON. REV. 323, 323 (1986) [hereinafter Jensen, *Agency Costs*]. On the notion of agency costs in financial economics generally, see MICHAEL C. JENSEN, *Stockholder, Manager, and Creditor Interests: Applications of Agency Theory*, *in* A THEORY OF THE FIRM: GOVERNANCE, RESIDUAL CLAIMS, AND ORGANIZATIONAL FORMS 136 (2000); Bengt Holmstrom, *Agency Costs and Innovation*, 12 J. ECON. BEHAV. & ORG. 305 (1989).

27. *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976). Although Jensen and Meckling are commonly regarded as the founders of agency costs theory, they were influenced to a large extent by previous works on the theory of the firm by Ronald Coase, Armen Alchian and Harold Demsetz. *See* Ronald H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937); Armen A. Alchian, *The Basis of Some Recent Advances in the Theory of Management of the Firm*, 14 J. INDUS. ECON. 30 (1965); Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777 (1972); Stephen A. Ross, *The Economic Theory of Agency: The Principal's Problem*, 63 AM. ECON. REV. 134 (1973).

28. *See* Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J.L. & ECON. 301 (1983).

29. *See* Jensen, *Agency Costs*, *supra* note 26, at 325-26; Jensen, *Eclipse*, *supra* note 25, at 1-2.

financial-accounting counterparts.[30]

Notwithstanding these seismic contextual changes, the Jensenian model of P.E., with its now-simplistic focus on mitigating owner-manager agency costs, remains the central theoretical paradigm through which P.E. buyouts are understood within law and finance scholarship. In the Authors' opinion, a critical reappraisal of the continuing relevance of the Jensenian theory of P.E. is now long overdue. As will be further shown below, it is even questionable to what extent the Jensenian model was truly representative of "big P.E." as a phenomenon when it was first advanced in 1989, let alone thirty-five years later.

This Article begins by setting out the key components of Jensen's agency costs rationalization of P.E., explaining how it was inspired by pertinent aspects of the market environment in the United States at the time. Using insights derived from extensive interviews with market participants, it then proceeds to chart the rise of multi-product suites ("MPSs") within the larger-scale segment of the P.E. sector today, explaining the powerful structural factors and economic pressures that have driven the progressive move away from monoline, purely-buyout-focused platforms. These include economies of scope, administrative efficiencies on both the supply and demand sides of the private capital market, and pressure on listed P.E. firms to maximize product-linked fee streams as a relatively stable revenue source. Subsequently, this Article identifies the ensuing agency costs arising from MPSs—specifically, between GPs and LPs of P.E. buyout funds—which have arguably just supplanted the traditional Jensenian owner-manager agency problem with a new, more latent, and more complex one.

Notably, existing literature on GPs' conflicts of interest has tended to focus more on operational conflicts arising from different GP investment activities. In contrast, this Article rather looks specifically at the relatively underexplored issue of GP conflicts arising from P.E. compensation practices, especially in relation to the prevailing balance of fixed and performance-based components therein. In this regard, it highlights the conflict between GP and LP interests where fee streams become a more attractive revenue source for P.E. firms than performance-based carry. It argues that this conflict encourages P.E. firms to adopt an asset-gathering mentality at the expense of maximizing fund capital gains, which is a critical new agency costs problem for the sector at large.

This Article shows how, consistent with the general contractarian thrust of the

30. As de Fontenay explains, "[u]ntil recently, private equity firms had a reputation for being leanly staffed." By contrast, though, "[t]oday's private equity firms often have a considerably larger workforce, and one that is increasingly composed of non-investment professionals, in areas such as marketing, legal, compliance, investor relations, government relations, and human resources." De Fontenay concludes that "[a]ccordingly, major private equity firms today look less like the small, scrappy teams of yore than like the large mutual funds advisers and investment banks." Elisabeth de Fontenay, *Private Equity's Governance Advantage: A Requiem*, 99 B.U. L. REV. 1095, 1117 (2019).

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Jensenian paradigm, a sophisticated array of private ordering mechanisms has evolved on both LP- and GP-sides geared to mitigating this new, post-Jensenian agency costs problem, albeit with varying degrees of success. It argues that reformers should be equally skeptical of dogmatic pro-market and pro-regulatory responses to GP/LP agency cost problems arising from MPSs and related compensation structures, although preliminary signs are that private ordering mechanisms overall appear to be working tolerably well in this arena. However, further empirical research of evolving market practices at a granular transactional level is needed before any definitive normative conclusions can be made. Finally, this Article posits that a critical reappraisal of the descriptive relevance of the Jensenian theory of private equity is now long overdue, to enable it to take account of this changed organizational context.

I. THE JENSENIAN CONCEPTUAL MODEL OF PRIVATE EQUITY

A. Agency Costs and LBOs

The dominant theoretical rationale for LBOs derives from the well-known "agency costs" theory of corporate finance and governance, which seeks to identify market pressures and other institutional structures that bring the interests of managers into line with those of investors.[31] It has been recorded how, by the 1980s, "[t]he general agreement among agency theorists was that managerial and shareholder interests had become woefully disjointed."[32] Accordingly, LBOs in effect "offered . . . an opportunity to provide managers the security they needed while at the same time making them substantial equity holders, so that divergent interests could be brought back into alignment."[33] As Jensen explained in his landmark 1989 *Harvard Business Review* article, *Eclipse of the Public Corporation*: "By resolving the central weakness of the large corporation—the conflict between owners and managers over the control and use of corporate resources—these new organizations [i.e., LBO firms] are making remarkable gains in operating efficiency, employee productivity, and shareholder value."[34]

Jensen further explained how, "[c]onsistent with modern finance theory, these organizations are not managed to maximize earnings per share but to maximize *value*, with a strong emphasis on cash flow."[35] He argued that "[a] central weakness and

31. On this, see *supra* notes 26–27.

32. GEORGE P. BAKER & GEORGE D. SMITH, THE NEW FINANCIAL CAPITALISTS: KOHLBERG KRAVIS ROBERTS AND THE CREATION OF CORPORATE VALUE 38 (1998).

33. *Id.*

34. Jensen, *Eclipse*, *supra* note 25, at 1–2. *See also* Michael C. Jensen, *The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems*, 48 J. FIN. 831 (1993).

35. Jensen, *Eclipse*, *supra* note 25, at 7. The key distinction between these two concepts is that, whereas corporate earnings are typically calculated on an "EBITDA" basis (denoting

source of waste in the large public corporation is the conflict between shareholders and managers over the payout of free cash flow—that is, cash flow in excess of that required to fund all investment projects with positive net present values when discounted at the relevant cost of capital."[36]

It purportedly followed that "[m]ore than any other factor, these organizations' (i.e., LBO firms') resolution of the owner-manager conflict explains how they can motivate the same people, managing the same resources, to perform so much more effectively under private ownership than in the publicly held corporate form."[37] Jensen claimed that "[w]ith its vast increases in data, talent and technology, Wall Street can allocate capital among competing businesses and monitor and discipline management more effectively than the CEO and headquarters staff of a typical diversified company," such that "KKR's New York Offices or Irwin Jacob's Minneapolis base are direct substitutes for corporate headquarters in Akron or Peoria."[38]

B. The Unique Incentive Structure of LBO Associations

Absolutely central to the high-powered incentive structure of an LBO Association (i.e., P.E. buyout fund) in Jensen's model are the mutually reinforcing concepts of carried interest and direct managerial equity investment. As Jensen explained, "[t]he general partners in an LBO Association typically receive (through overrides and direct equity holdings[39]) twenty percent or more of the gains in the value of the divisions they help manage," which "implies a pay-for-performance sensitivity of $200 for every $1,000 in added shareholder value."[40]

In particular, the longstanding sectoral practice of requiring the individual GP partners/associates and portfolio company managers involved in a buyout to invest

earnings before interest, tax, depreciation, and amortization), free cash flow is ordinarily calculated *after* deducting tax, asset depreciation and amortized capital expenditures from net profit, thereby purportedly providing a more realistic and tangible assessment of the relevant company's financial performance.

36. *Id.* at 9. In an earlier work, Jensen further explained how "[c]onflicts of interest between shareholders and managers over payout policies are especially severe when the organization generates substantial free cash flow," with the problem being "how to motivate managers to disgorge the cash rather than investing it at below the cost of capital or wasting it on organization inefficiencies." *See* Jensen, *Agency Costs*, *supra* note 26, at 323.

37. Jensen, *Eclipse*, *supra* note 25, at 7.

38. *Id.* at 13–14.

39. It is customary for GPs to provide one percent of the overall capital contribution to a buyout via their own proprietary funds. *See* Kobi Kastiel & Yaron Nili, *The Rise of Private Equity Continuation Funds* 172 U. PA. L. REV. 1601 (2024).

40. Jensen, *Eclipse*, *supra* note 25, at 16. On the notion of managerial pay-for-performance sensitivity generally within the Jensenian thought paradigm, see Michael C. Jensen & Kevin J. Murphy, *Performance Pay and Top-Management Incentives*, 98 J. POL. ECON. 225 (1990).

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their own risk capital directly in the portfolio company, as opposed to receiving shares and/or options for free as part of their contractual compensation (as has traditionally been the case for public company CEOs[41]), has been rationalized from an agency theory standpoint in the following compelling terms:

> The nature of the relationship between owners and managers in a highly leveraged firm rested on a basic principle: make managers owners by making them invest a significant share of their personal wealth in the enterprises they manage, thus giving them stronger incentives to act in the best interests of all shareholders.[42]

Jensen's agency theory rationalization of LBOs was predicated on capital gains being the core and dominant source of returns for LBO partnerships and, in turn, the buyout firms who acted as their GPs. Indeed, as was emphasized in an authoritative historical account of KKR's early development, "at the consummation of every deal, after KKR—along with a battery of lawyers, accountants, investment bankers, and others—collected their fees, the real money [principally in the form of carried interest] was yet to be made."[43] From this perspective, it was therefore of critical importance that ultimate capital gains, as opposed to ongoing revenue streams from fees, remained the principal driving motivation for GPs' dealmaking and subsequent portfolio management activities.[44]

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41. On the distinction between P.E. and listed portfolio company compensation practices in this regard, see DAVID CAREY & JOHN E. MORRIS, KING OF CAPITAL: THE REMARKABLE RISE, FALL, AND RISE AGAIN OF STEVE SCHWARZMAN AND BLACKSTONE 320 (2010). The authors additionally highlight here how, in P.E.-owned portfolio companies, managers have traditionally been obliged to forfeit any unvested equity that they own in the event of being dismissed for underperformance, unlike in public companies where "fired" managers often receive an effective "windfall" in the form of accelerated vesting of any stock options received as part of their compensation. This arguably mitigates the perverse managerial incentive of such perceived "rewards for failure" in the listed sector. On the notion of "rewards for failure" generally in the context of executive compensation, *see* JAMES BARTY & BEN JONES, EXECUTIVE COMPENSATION: REWARDS FOR SUCCESS NOT FAILURE (2012), https://perma.cc/B4FG-WPT4.

42. BAKER & SMITH, *supra* note 32, at 96. During KKR's formative decades, managerial equity incentives–whether in form of direct shareholdings or deferred share option grants–customarily gave portfolio company managers up to twenty-five percent exposure or five to ten percent in the case of larger scale buyouts. These numbers are extraordinarily large compared to typical levels of ownership exposure in public companies and larger non-buyout private companies.

43. *Id.* at 90.

44. In this regard, Baker and Smith (writing in 1998) note that, at least in the first two decades of KKR's existence, "[s]ustained commitment to solving financial problems was built into the incentive structure of the buyout business" insofar as "the big money was earned only when assets were sold." *Id.* at 161. Notably, though, from its 1996 fundraising onwards, KKR began the now well-established industry practice of "netting" its profits and losses

C. LBO Firms and Organizational Smallness

Likewise at the core of the Jensenian model of LBOs was the notion of P.E. firms as relatively small-scale, operationally-focused organizations where both control and incentives were centralized in a close and connected group of investment professionals and ancillary support staff. In this regard, Jensen—writing at the tail-end of the 1980s (U.S.) LBO boom in 1989–observed how "[t]he headquarters of KKR, [then] the world's largest LBO partnership (i.e., firm), had only 16 professionals and 44 additional employees in 1986,"[45] which he contrasted starkly with the corresponding figures for KKR's famous 1988 acquisition target RJR Nabisco, who, at the time, employed 470 people at its Atlanta headquarters alone.[46]

Meanwhile, based on an empirical study of seven LBO firms carried out in the late 1980s, Jensen "found an average headquarters staff of 13 professionals and 19 non-professionals that oversees almost 24 [portfolio company] business units with total annual sales of more than $11 billion."[47] These figures ranged from, at the uppermost end, the abovementioned case of KKR with sixteen and forty-four professional and non-professional staff respectively; to, at the lowermost end, (the now long-defunct) Gibbons Green van Amerongen with only six investment professionals and seven additional support staff.[48]

As late as 1997, KKR reportedly had just eleven partners and a further ten associates and analysts despite having over $6 billion of "dry powder" (i.e., unallocated risk capital committed by LPs) at that time.[49] Against this backdrop, P.E. was widely perceived in the 1980s and 1990s (at least in the United States) as a small-scale "boutique" phenomenon, a characterization no doubt precipitated by the

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from all deals undertaken by any P.E. fund in determining the GP's entitlement to carried interest, as opposed to the previous norm of calculating carry entitlement on the basis of profits and losses from each individual deal. This was designed to mitigate a GP's incentive to dispose of underperforming investments–on which they were unlikely to generate the requisite (eight percent) hurdle rate of return to activate their carry entitlement–prematurely as opposed to seeking to work through the ongoing challenges faced by the underlying businesses. *Id.* at 203. Meanwhile, Blackstone has reportedly determined and calculated its carry entitlement on a whole fund rather than single-asset basis even longer than that, since the mid-1980s. *See* CAREY & MORRIS, *supra* note 41, at 52-53.

45. Remarkably, KKR's $59 billion of assets under management immediately after the RJR Nabisco buyout was surpassed by only four Fortune 500 corporations at the time, namely General Motors, Ford, Exxon and IBM. Moreover, these assets were ultimately overseen by just six GPs. *See* BAKER & SMITH, *supra* note 32, at 27.

46. Jensen, *Eclipse*, *supra* note 25, at 16.

47. *Id.* at 17.

48. *Id.* at tbl. 2. Other notable "cottage" or "boutique" LBO firms in the United States operating in late 1970s and early 1980s included Forstmann Little and Company, E.M. Warburg Pincus, AEA Investors, Thomas H. Lee Company, Carl Marks and Company, and Dyson-Kissner-Moran. CAREY & MORRIS, *supra* note 41, at 32–33.

49. BAKER & SMITH, *supra* note 32, at 203.

apparent "David and Goliath" dynamic of some high-profile early buyouts, such as KKR's abovementioned acquisition of RJR Nabisco.[50]

But far from being a proverbial new kid on the P.E. block at the time, the industry pioneer KKR had been formed in 1976, more than a decade before its Nabisco deal. This was when three former Bear Sterns dealmakers—Jerome Kohlberg, Henry Kravis and George Roberts—left the mainstream investment banking world to form their own independent financial partnership.[51] KKR's early competitor LBO firms in 1970s New York such as Forstmann Little and Company and Clayton, Dubilier & Rice were also formed around this time.[52] In due course, P.E. buyout departments would also become a common feature of large, mainstream investment banks and brokerage houses such as Morgan Stanley and Merrill Lynch.[53]

II. DESEGREGATION AND THE EVOLUTION OF MULTI-PRODUCT SUITES

A. Motivation for Conducting Empirical Research into MPSs

The evolution of MPSs is a relatively recent but also highly significant phase in the history of the P.E. sector. Whilst functional diversity and organizational complexity have been characteristic features of many financial-professional sectors in recent times (and especially so in the case of investment banks and accounting firms), P.E. has by contrast been perceived as a largely monoline and slim product market environment,

50. Indeed, this deal attained almost legendary popular status after subsequently being depicted in the book BARBARIANS AT THE GATE. BURROUGH & HELYAR, *supra* note 24.

51. BAKER & SMITH, *supra* note 32, at 58-59. The principal attraction of leading on LBO buyouts from the standpoint of investment bankers was the opportunity that they provided not just to reap ancillary transactional fees from underwriting, advisory and securitization, but also to capture the principal capital gains from those deals that would otherwise accrue to clients. However, at least initially, many mainstream investment banks were reluctant to expand the conventional scope of their corporate financing activities in this way. On this, see GUY HANDS, THE DEALMAKER: LESSONS FROM A LIFE IN PRIVATE EQUITY 85-86 (2021).

52. BAKER & SMITH, *supra* note 32, at 3. In a similar vein, the present-day P.E. giant Apollo Global Management emerged in 1990 from the bankruptcy of the investment bank Drexel Burnham Lambert and was formed by three of Drexel's former executives: Leon Black, Joshua Harris, and Marc Rowan. *See* JASON KELLY, THE NEW TYCOONS: INSIDE THE TRILLION DOLLAR PRIVATE EQUITY INDUSTRY THAT OWNS EVERYTHING 44 (2012).

53. BAKER & SMITH, *supra* note 32, at 75. Investment banks' traditional reluctance to become direct (as opposed to intermediary) players in the P.E./LBO market was due to their dependence on maintaining the trust of corporate clients, which they feared would be eroded if investment banks were to become direct competitors to their clients in the M&A arena. However, in the United States at least, the period of 1986-1988 was something of a zeitgeist moment for investment banks, during which they increasingly took up significant equity positions in P.E. buyout targets on their own account. *See* Allen Kaufman & Ernest J. Englander, *Kohlberg Kravis Roberts & Co. and the Restructuring of American Capitalism*, 67 BUS. HIST. REV. 52, 80-81 (1993).

centered on the traditional corporate buyout. Acknowledgement of the descriptive inaccuracy of this picture, and, correspondingly, the substantial structural similarities between "big P.E." and other neighboring industry sectors, have potentially profound ramifications.

Although there is some degree of academic awareness of multi-product P.E. suites and the problems they can create,[54] the literature is still relatively thin. In view of the characteristically opaque nature of the P.E. sector (at least compared to other well-established financial asset classes) and the relatively low profile of most key individuals involved in the sector, the Authors were keen to extend the scope of public understanding of these issues. Therefore, in addition to examining theoretical rationales for and against MPSs, the Authors also sought to gain some "real-world" insights from inside the P.E. industry space itself as to the main perceived drivers of MPSs, along with the key risks and challenges these structures are believed to pose in the eyes of those who are principally affected by them.

B. Empirical Research Methodology

Accordingly, the Authors conducted semi-structured qualitative interviews with numerous P.E. sector participants from both the LP (supply) and GP (demand) sides of the P.E. capital market.[55] The questions asked in the interviews essentially revolved around four core themes, namely: (i) the main economic drivers of MPSs in preference to traditional monoline product suites (including, in particular, the ramifications of P.E. firm public listings); (ii) the main economic conflicts arising from MPSs, especially in relation to prevailing GP compensation structures; (iii) the main internal-organizational mitigants of such conflicts within P.E. firms; and (iv) the continuing descriptive (ir)relevance of the "private equity" descriptor in the context of MPSs.[56]

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54. *See infra* Part III.

55. In total, the Authors interviewed sixteen individuals whose experience and perspectives were relevant to this project. Half of the participants were from the LP (supply-side) contingent of the P.E. capital market, and the other half were from the GP (demand-side) contingent.

56. For reasons associated with the Authors' work locations and surrounding professional networks, most interview participants were representative of organizations based in Northern Europe (with London being the predominant location), although a fairly significant minority of participants were representative of either North American or Australasian organizations. Specifically, 69% (11/16) of interview participants were from organizations based in northern Europe. Within that sub-group, 45% (5/11) participants were from the LP (supply-side) contingent and 55% (6/11) were from the GP (demand-side) contingent of the P.E. capital market. 31% (5/16) of interview participants were from organizations based in either North American or Australasia. Within that sub-group, 60% (3/5) were from organizations based in North American and 40% (2/5) were from organizations based in Australasia. Meanwhile, 80% (4/5) were from the LP (supply-side) continent and 20% (1/5) was from the GP (demand-side) contingent of the P.E. capital market. Wherever possible, the Authors sought to triangulate data across different geographical locations to identify mutually reinforcing commonalities in participant

Most interviews were carried out virtually (via Zoom) during the coronavirus "lockdown" periods in 2020 and 2021, when almost all respondents were based at home. Therefore, participants were generally more readily available for interview than they might otherwise have been. This made it possible for the Authors to conduct interviews with greater administrative efficiency and substantive depth.

The Authors intentionally adopted, at different points of their discussions with participants, both experimental (theory-testing) and exploratory (theory-generating) approaches.[57] On some issues, they sought to examine the validity and relevance of existing conceptualizations of the subject matter (e.g., the agency costs conceptualization of P.E. buyouts), and, on other issues, they deliberately opted to give participants discursive leeway to provide independent subjective perspectives that were more conducive to generating new theoretical constructs or paradigms. This was achieved by toggling between: (1) the Authors' (relatively broad) scripted questions, and (2) indirect or tangential lines of questioning provoked by participants' real-time responses to the Authors' primary lines of questioning, in a format that is typical of semi-structured interviewing in qualitative social-scientific research generally.

As co-interviewers, the Authors intentionally adopted a dual emic (subjective insider) / etic (objective outsider) stance in relation to participants.[58] Each co-interviewer occasionally adopted a deliberately stylized (and polarized) discursive manner. Accordingly, Mr. Hale—as a seasoned professional operator in the P.E. sector with considerable lived experience in the field—typically assumed the stance of what the social scientists Erica Hallebone and Jan Priest have termed an "engaged co-participant."[59] This had the advantage of enabling discussions to quickly hone in on granular or specialist practical lines of inquiry that might otherwise have been precluded or explored less thoroughly in the interviews.

By contrast, Professor Moore—as an academic researcher of the subject with no direct lived experience in the relevant field—tended to adopt the stance of "objective

responses. They identified the selected group of interview participants initially via Mr. Hale's extensive professional network developed over the course of a four-decades-long career as a leading London-based P.E. lawyer, during which time he notably founded Travers Smith LLP's Private Equity & Financial Sponsors Group in 1996 and was subsequently the firm's Senior Partner from 2013 through 2019. Additional participants were thereafter identified by "snowball" sampling based on solicited recommendations from the initial interview participants, thereby expanding the group of interviewees significantly beyond the Authors' own direct industry contacts. On this (widely recognized) empirical research method generally, see Charlie Parker et al., *Snowball Sampling*, SAGE RSCH. METHODS (Sept. 17, 2019), https://doi.org/10.4135/9781526421036831710.

57. On these concepts generally (and the distinction between them), see ERICA HALLEBONE & JAN PRIEST, BUSINESS & MANAGEMENT RESEARCH: PARADIGMS & PRACTICES 28 (2009).

58. On these concepts generally (and the distinction between them), see *id.* at 28-29.

59. *Id.* at 29.

and dispassionate observer and analyst."[60] In appropriate instances, this perspective proved helpful in prompting participants to withdraw from their specialized insider's mindset and, instead, observe then explain the relevant subject matter on a more arm's length and/or coarse-grained basis. At times, this strategy also had the secondary advantage of encouraging participants to reflect critically on assumptions or phenomena they might otherwise have taken for granted in the manner of "it's just what tends to happen in practice."

The Authors used the interview findings principally for the purpose of examining existing academic literature, especially (but not exclusively) the Jensenian agency costs conceptualization of P.E. associations and buyouts. At the same time, they sought, wherever possible, to triangulate the empirical research findings with existing literature on points of commonality, and/or identify notable gaps in existing academic knowledge vis-à-vis MPSs, or inconsistencies between the literature and the subjective perspectives of P.E. industry insiders on the same issues.

Although the findings are necessarily anecdotal in nature to some extent, the Authors nonetheless sought as much as possible to identify points of co-validation between different interview subjects. Relatedly, the Authors adopted a snowballing approach to correlating responses between successive subjects, insofar as points made by previous respondents were sometimes intentionally put (on an anonymized basis) to subsequent interview subjects to elicit the latter's agreement or disagreement therewith.

As with any qualitative, inter-subjective empirical research project of this nature, there is an obvious risk of bias in relation to participant selection. To mitigate partiality of perspective in the responses, the Authors interviewed an equal number of participants from the GP (demand) and LP (supply) sides of the P.E. capital market. Nonetheless, the Authors acknowledge that, insofar as the interviewed LP organizational representatives tended to be members of the alternative asset management community generally (even if employed by mainstream institutional investment firms), they arguably had the same innate self-legitimation bias as the GP representatives in the sample.

In other words, it could be argued that both the LP and GP representatives in the sample were positionally inclined to seek to legitimize the activities of the P.E. sector as a whole, notwithstanding their identification of specific issues or problems therein. That said, since the Authors' research focus in this project was intentionally positioned at more of a micro-granular than macro-normative level, this is not deemed a material risk to the descriptive validity of the Authors' findings in the context of this Article.[61]

60. *Id.* at 28.

61. As mentioned above, all interviews were conducted online using the Zoom platform. With the participants' express prior permission, the interviews were recorded and thereafter transcribed automatically using the MS Stream software program. Although the Authors initially experimented with the NVivo software program for coding the interview data, they did not find this especially helpful for the specific nature of their research project. Therefore, they decided instead to code the data manually using

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C. From Private Equity to Private Markets

Having explained the motivation and methodology for interviews with P.E. market participants, it is time to assess some of the key findings and implications from those interviews. A prominent theme that arose from discussions with market participants was the inability of the term "private equity" to capture the full scope of common sectoral activity today. The Authors frequently heard reference to the alternative term "private markets" as a more comprehensive descriptor for the illiquid/non-publicly traded asset ownership model generally, which today covers not just traditional P.E. but also, inter alia, infrastructure, private debt, and real estate.[62] More accurately and comprehensively, a representative of one such P.E. firm described themselves as "multi-asset class, private capital managers."[63]

Although relative organizational smallness and bureaucratic simplicity were critical qualities of the ideal-type LBO firms in Jensen's classical 1980s sectoral blueprint, Jensen was by no means blind to the possibility of that landscape changing

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Auerbach and Silverstein's method of qualitative data coding and analysis, which essentially entails generating a set of repeating ideas from relevant text collated across different interview transcripts. *See generally* CARL F. AUERBACH & LOUISE B. SILVERSTEIN, QUALITATIVE DATA: AN INTRODUCTION TO CODING AND ANALYSIS (2003). These repeating ideas were then used for the purpose of creating a set of research hypotheses which, in turn, informed the development of new theory and/or the testing of existing theory. After completing the coding of the interview data, the interview recordings were destroyed. In the interim period, and purely for transcribing and coding purposes, they were stored in a password-protected Outlook cloud storage folder that only the Authors and Mr. Hale's personal assistant had access to. All interview participants were informed about these data processing and storage arrangements in advance of consenting to be interviewed and recorded for the project. Furthermore, all interview data was recorded and coded on a fully anonymized basis with no attribution to any specific individual or organization (other than the mentioning of whether they were on the LP/supply or GP/demand side of the P.E. capital market), and all interview subjects expressly consented to participate on those terms. All interviews were conducted in accordance with the UCL Code of Conduct for Research and with the formal authorization of the UCL Faculty of Laws Local Research Ethics Committee. *See Research Integrity*, UNIV. COLL. LONDON RSCH. & INNOVATION SERVS. (2024), https://perma.cc/AF3R-FXWS; *Research Ethics and Academic Integrity*, UNIV. COLL. LONDON FAC. OF L., https://perma.cc/83LQ-SBU7 (it should be noted that, at the time the interviews were conducted, Professor Moore worked at UCL but had subsequently moved to a new position at the University of Nottingham).

62. For instance, of the $331 billion in private market assets that Apollo reported to have under management at the end of 2019, only $77 billion was in equity with the remainder principally in debt ($216 billion) and, to a lesser extent, real estate ($39 billion). *See* Phalippou, *supra* note 15, at 25 (citing Apollo's 2019 10-K filing). Furthermore, one demand-side respondent reported what they believed to be decreasing demand from defined-contribution pension funds for private equity assets, and on correspondingly increasing demand for private debt assets due to the latter's guaranteed fixed yield profile.

63. Nevertheless, the Authors prefer the (interchangeable) terms "private capital" or "private markets" because of brevity and ease of use.

with the continuing growth and success of the sector. In his 1989 article, Jensen admitted that "we have yet to fully understand the limitations on the size of this new organizational form," while accepting that "LBO partnerships are understandably tempted to increase the reach of their talented monitors by reconfiguring divisions as acquisition vehicles."[64]

Jensen acknowledged—correctly, as it would transpire—that "[t]his will be difficult to accomplish successfully [and] . . . is likely to require bigger staffs, greater centralization of decision rights, and dilution of the high pay-for-performance sensitivity that is so crucial to success."[65] Jensen's seemingly greatest concern in this regard was that "[a]s LBO Associations expand, they run the risk of recreating the bureaucratic waste of the diversified public corporation."[66] However, as explained below, such organizational complexity and functional diversity were, from a comparative and historical standpoint, much more enduring characteristics of the P.E. sector than might initially have seemed the case in late-1980s America.

D. The MPS's Post-War British Origins

Curiously, in the U.K., the desegregated multi-product P.E. platform—far from being a recent or novel development—in fact predates the Jensenian, ideal-type P.E. boutique by quite some distance. Britain's most well-known P.E. trailblazer 3i, in its early guise as the Industrial and Commercial Finance Corporation ("ICFC"), was committed from its very beginning to establishing a diverse, multi-product suite in addition to its core, principal investment activities.[67] Given ICFC's commercial independence and corresponding lack of government financial support, its successive chairmen were acutely aware of the firm's need to turn a profit alongside fulfilling its de facto public responsibility of capitalizing Britain's small and medium-sized enterprises sector.[68] This was, indeed, a precondition to the firm's own survival and continuing growth.

Thus, from its inception in 1945, ICFC pursued an aggressive diversification strategy that enabled its operations to intersect other financial services sectors whenever opportunities for additional capital growth and/or revenue streams presented themselves.[69] Noteworthy examples of ICFC ventures of this nature include its establishment in 1967 of a new subsidiary company, Industrial Mergers Ltd., for the purpose of gaining a foothold in the increasingly lucrative M&A advisory sector. This enabled ICFC to establish a significant new fee-generating activity on the back of the

64. Jensen, *Eclipse*, *supra* note 25, at 28.
65. *Id.*
66. *Id.*
67. RICHARD COOPEY & DONALD CLARKE, 3I: FIFTY YEARS INVESTING IN INDUSTRY 30 (1995).
68. *Id.* at 15.
69. *Id.* at 43.

merger wave that was sweeping across many British industries at the time.[70] Other notable new product lines that ICFC ventured into around this time included hire purchase, commercial property leasing, management consultancy, IT services, and shipping finance.[71]

E. The Blackstone Group

Unquestionably, the principal pioneer of the P.E. MPS in the U.S., meanwhile, was (and arguably still is) the Blackstone Group ("Blackstone"). By 2007, Blackstone had surpassed KKR and The Carlyle Group as the world's largest P.E. firm as measured by AUM, with $88 billion of assets under management at the time.[72] As far back as the early 1990s, Blackstone had broken new ground by becoming the first large P.E. firm to open a significant real estate fund.[73] By the time of the market peak in 2007, Blackstone–despite ostensibly being a corporate buyout specialist–reportedly had a $100 billion real estate portfolio under management alongside a $50 billion fund of funds business and sizeable M&A advisory and restructuring operations in addition to numerous other equity and debt funds.[74] According to one especially vivid observation, the firm had consequently become "a fabulously profitable new form of Wall Street powerhouse whose array of investment and advisory services and financial standing rivalled those of the biggest investment banks."[75]

However, far from representing a midstream switch in Blackstone's business model away from that of a traditional LBO house, Blackstone was—unlike many of its P.E. sectoral peers—originally designed as a multi-product platform. From its inception in 1985 (which, curiously, was four years *before* Jensen's landmark article was published[76]), Blackstone was always intended to be a "hybrid" business operation in the sense of being similarly committed to providing intermediate M&A advisory work as it was to undertaking principal corporate buyout activity. The attraction of M&A advisory business for Blackstone's co-founders, Steve Schwarzman and Pete Peterson, was the combination of high fees with relatively low overheads and capital commitments entailed, at least in comparison to more capital-intensive buyouts and traditional investment bank underwriting work.

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70. *Id.* at 87.
71. *Id.* at 90–93.
72. CAREY & MORRIS, *supra* note 41, at 5.
73. *Id.* at 132–33.
74. *Id.* at 5.
75. *Id.* at 6. Meanwhile, Blackstone's main industry rival KKR was notoriously described by the former firm's co-founder Steve Schwarzman in 1998 as a "one-trick pony" on account of its perceived inability and/or unwillingness to diversify to a similar extent at the time. *See id.* at 142.
76. *See* Jensen, *Eclipse*, *supra* note 25.

Schwarzman and Peterson would, in due course, come to expand Blackstone's product suite (and ensuing fee base) further via the addition, inter alia, of affiliate fixed income investment as well as real estate businesses,[77] the former of which would ultimately spin off under Larry Fink's leadership to become the contemporary asset management behemoth, BlackRock.[78] The enormous, market-leading scale of Blackstone's real estate fund was demonstrated most pertinently in 2007 when it broke the then-record for the biggest ever P.E. buyout to date with its $387 billion acquisition of Equity Office Properties.[79]

F. Key Economic Drivers of MPSs

When Jensen advanced his agency costs rationalization of private equity in the 1980s, the P.E. industry was still dominated in large part by traditional monoline buyout firms. However, as explained above, the MPS was—at the time—in the process of becoming an increasingly prevalent feature of the sector. This trend has further intensified since then.

The main driver of P.E. firms' increasingly expanding scope of investments is the saturation of their core buyout market, with increasing inflows of capital chasing a finite range of prospective buyout targets. It is also widely recognized that, especially in a low interest environment (that generally existed from the 2008 global financial crisis until the end of 2021), the risk-adjusted opportunity cost to funds of not allocating capital entrusted to them will tend to be perceived as higher than the corresponding cost of investing that capital sub-optimally, such that the well-known "urge to action rather than inaction"[80] becomes a prevalent GP characteristic.[81] At the same time, the fact that a GP's physical accommodation and other back-office costs are likely to remain largely fixed notwithstanding the broader scope of its product suite makes multi-product offerings less logistically onerous as would be the case in other, more capital-intensive sectors.

The propensity for larger P.E. firms today to constitute multi-product "one-stop shops" for their clients can also create considerable economies of scope[82] by enabling

77. Curiously, one commentator (writing in 2012) observed how "[r]eal estate, credit, and hedge funds at Blackstone dwarf private equity by most measures." *See* KELLY, *supra* note 52, at 183.

78. CAREY & MORRIS, *supra* note 41, at 46.

79. *Id.* at 253.

80. JOHN MAYNARD KEYNES, THE GENERAL THEORY OF EMPLOYMENT, INTEREST, AND MONEY 161 (1936).

81. On the other hand, as de Fontenay has highlighted, having high levels of unallocated capital can be a potential curse as well as a blessing for P.E. firms, if the outcome is a lower rate of return for investors due to a surplus of funds chasing limited value-enhancing acquisition opportunities. *See* de Fontenay, *supra* note 30, at 1106.

82. On the notion of economies of scope generally within industrial organization, see ALFRED D. CHANDLER, JR., SCALE AND SCOPE: THE DYNAMICS OF INDUSTRIAL CAPITALISM (1994).

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LPs to invest simultaneously in different equity, debt, and other funds offered by a trusted and proven GP, thereby reducing the additional search costs that would otherwise be involved in trialing new managers to meet LPs' potentially diverse investment needs. There is also the related administrative efficiency for LPs of dealing with one single GP across a variety of asset classes as opposed to a fragmented group of institutions from diverse investment sectors.[83]

One supply-side respondent referred to the above phenomenon as "backing the brand," which, in practice, can provide significant comfort to many LPs where they deal with a trusted market leader such as Blackstone or Carlyle, while also enabling LPs to benefit from fee breaks and other benefits offered by mega-buyout firms in return for making multifarious investments across the latter's product suite. In this regard, the continuing and growing willingness of many sophisticated institutions to invest their capital in multi-product private capital suites can arguably be viewed as an implicit market endorsement of the modern conglomerate model.

Likewise, multi-product platforms can create administrative efficiencies on the demand side by enabling GPs to exploit their knowledge, expertise, and infrastructure across multiple asset classes, such as where a larger GP's fundraising team uses its existing investor networks to raise capital for its debt and/or infrastructure funds in addition to its equity funds.

However, not all interviewees on the supply side bought into the "one-stop shop" view of multi-product offerings. The Authors learned from the representative of a multi-product P.E. firm how many LPs have historically tended to oscillate between concentrated and more dispersed capital allocation patterns at different points in time, depending on the relative strategic importance to an LP of concentrating its relationship base vis-a-vis diversifying and refreshing its GP talent pool.

G. *Potential Limitations on the Further Expansion of MPSs*

A significant driver of the expansive growth of MPSs in recent years has been the phenomenon of P.E. firm public listings. In recent years, public listings have proved a popular way for larger-scale P.E. firms to raise significant outside capital for organizational expansion while simultaneously realizing value for these firms'

83. There would appear to be something of a parallel here between the practices of multi-product P.E. platforms today and those of many large-scale commercial banks in the 1990s (especially in the United States following the repeal of the Glass-Steagall Act's former firewall between commercial and investment banking activities), whereby disparate product offerings across both the commercial and investment banking suites were commonly 'tied' together such that preferential terms in the former regard would be available to those clients who purchased services in the latter regard. *See* ALAN D. MORRISON & WILLIAM G. WILHELM, JR., INVESTMENT BANKING: INSTITUTIONS, POLITICS, AND LAW 21 (2007).

founding owner-managers.[84] Supply-side interviewees emphasized the importance of prospective public issuers from the P.E. sector being "match fit" for IPO, including having a multi-product platform to enable long-term growth beyond just the (limited) buyouts realm,[85] together with a strong governance structure and overall attractive growth profile including a presence in numerous geographic markets.[86]

Due to these limiting parameters, it is therefore likely that only a limited number of P.E. firms will have the degree of both scale and scope necessary to support an IPO, with one supply-side respondent predicting that no more than approximately twenty-five firms globally would likely satisfy this threshold. It was also underscored to the Authors that, notwithstanding the above developments, "the equity buyout is still very much core" in terms of distinguishing private equity from other financial-professional subsectors such as investment banking or accounting conglomerates (e.g., JP Morgan or PwC, respectively). Moreover, unlike these other subsectors, P.E. has for the most part tended not to diversify into the M&A advisory or management consultancy spaces.[87]

III. ECONOMIC CONFLICTS ARISING FROM GP COMPENSATION STRUCTURES IN CONNECTION WITH MPSS

It is well-accepted today that corporate ownership concentration, far from resolving the Jensenian agency costs problem, instead serves only to reposition that

84. *See* Kaye Wiggins & Antoine Gara, *Inside Private Equity's Race to Go Public*, FIN. TIMES (Jan. 9, 2022), https://perma.cc/TJJ8-FSDL.

85. This fact has likewise been remarked on in the literature, with Carey and Morris highlighting the importance of product suite diversity for publicly traded P.E. firms so that outside investors don't have too many of their eggs in one basket. *See* CAREY & MORRIS, *supra* note 41, at 327. Indeed, the importance of product diversification for listed P.E. firms from an earnings management perspective is demonstrated by the significant share price growth experience by the largest global P.E. firms in 2023 (including, inter alia, Blackstone, KKR and Apollo)—largely on the back of revenue growth from credit and insurance products—notwithstanding a contemporaneous sector-wide drop-off in deal volumes, exits and cash distributions to fund LPs. *See* Antoine Gara, *Private Equity Chiefs Enjoy $40bn Gain in Share Value as Assets Surge*, FIN. TIMES (Feb. 12, 2024), https://perma.cc/JD4K-GFH3.

86. A notable recent case in point is the European buyout giant CVC Capital Partners' decision to buy the private capital management firm Glendower Capital and the infrastructure investor DIF Capital to diversify its product suite ahead of its intended IPO on the Amsterdam Stock Exchange in late 2023 (which ultimately took place in April 2024). *See* Kaye Wiggins & Will Louch, *CVC Prepares to Launch IPO as Early as Next Week*, FIN. TIMES (Oct. 18, 2023), https://perma.cc/E4XW-PY23; Swetha Gopinath, *CVC Rises After €2 Billion IPO in Europe's Best Debut in Years*, BLOOMBERG (Apr. 26, 2024), https://perma.cc/5F59-B2VY.

87. The U.S. "mega-buyout" firms KKR, Blackstone, and Apollo stand out as notable exceptions to this trend.

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problem within other relational contexts.[88] In their 2013 article *The Agency Costs of Agency Capitalism* ("*ACoAC*"), Ronald Gilson and Jeffrey Gordon showed how, with the increasing concentration and professionalization of corporate ownership in the hands of institutional investors, the classical shareholder-management agency costs problem has been replaced by a new agency costs problem between the record and beneficial shareholders of investee companies.[89] Hence, there is a potential for the divergence of interests between, on the one hand, those professional institutions (as "agents") entrusted with holding and voting (or not) on the relevant shares, and, on the other hand, the dispersed community of (typically non-professional) beneficiaries (as "principals") who bear the brunt of the corresponding economic risk exposure.[90]

However, for the most part, analyses of the *ACoAC* problem have tended to focus principally on its manifestations in the field of public company ownership by retail-facing institutional investors such as mutual funds, which are substantially different from its effects in the realm of GP-to-LP P.E. fund relations. Accordingly, in the discussion that follows, the Authors will concentrate on the specific ramifications of Gilson and Gordon's *ACoAC* theory for P.E. compensation structures and the economic conflicts they are prone to create, which are relatively underexplored in the literature.[91]

88. For detailed expositions of how concentrated corporate ownership structures interrelate with corresponding agency cost challenges, see, e.g., Heejung Byun & Tae-Hyun Kim, *Principal-Principal Agency Problem and Shareholder Activism: The Rise of Minority Shareholder Movement in Korea 2001-2008*, 2013 ACAD. MANG. PROC. 956 (2013) (examining this issue in relation to publicly traded South Korean firms); Mark Bagnoli et al., *Family Firms, Debtholder-Shareholder Agency Costs and the Use of Covenants in Private Debt*, 7 ANN. FIN. 477 (2011) (examining this issue in relation to S&P family firms).

89. *See* Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863 (2013).

90. *See id.* at 874-84.

91. An issue that the Authors believe *has* been relatively well-explored in the literature is that of operational conflicts in relation to the different investment activities of multi-product GPs. From a governance perspective, the essential problem here is that "credit funds have very different incentives and require different expertise than equity funds." De Fontenay, *supra* note 30, at 1113. It follows that, where a P.E. firm is simultaneously taking equity and debt position in the same company, there is potential for inter-fund conflict given the manifest divergence between the respective interests of debt-holder and equity-holder interests in numerous respects. *See id.* at 1113-14. At the same time, though, dual equity and debt ownership can potentially be *beneficial* from a corporate perspective insofar as it reduces shareholder-creditor agency costs vis-à-vis P.E. portfolio companies. Taking dual equity and debt positions in the same portfolio company can also elicit significant savings in GP monitoring costs insofar as information acquired in one capacity can be used for the benefit of the other, without necessarily incurring fiduciary liability (assuming that either the relevant conflict has been approved or the GP's fiduciary duties have been waived by one or both of these funds' Limited Partner Advisory Committees. *See* William A. Birdthistle & M. Todd Henderson, *One Hat Too Many? Investment Desegregation in Private Equity*, 76 U. CHI. L. REV. 45, 46-47 (2009). In his classic 1989 article, Jensen

A. The Risk of Carried Interest Becoming Mere "Icing on the Cake" for GPs

Numerous market participants explained to the Authors how the potential mutual efficiencies for GPs and LPs of multi-product platforms do not come without corresponding risks. One supply-side respondent who was generally supportive of the above conglomerate model nonetheless expressed to the Authors their concern that the lower the proportion of a GP's overall income that is dependent on the performance of its equity buyout funds, the greater the risk of its focus being obfuscated to the detriment of those funds' LPs.

In a similar vein, another supply-side respondent explained how, as larger P.E. firms come to operate an ever-greater variety and scale of funds for clients, the ongoing fees charged on those funds become an ever more prominent component of such firms' overall profitability. Moreover, such fees include not just GPs' well-known annual management fee but potentially also transaction fees (typically levied on deal completion) and post-deal monitoring fees.[92] The negative flipside to this is that the actual performance-sensitive component of P.E. firms' client income, namely the carried interest accrued on their funds, increasingly becomes—in the words of one supply-side respondent—"the icing on the cake as opposed to the thing which should be driving them."[93]

Yet another supply-side respondent highlighted to the Authors that, while general levels of carried interest received by successful GPs are unquestionably high, in practice "not a lot of people earn carried interest . . . for all the noise that comes from it." This is because, to receive carried interest, a GP needs to ensure that investors get back the whole of their initial investment committed to the relevant deal or fund, together with an eight percent compound yield over and above that whether as calculated on an individual deal-by-deal basis (as is customary in the United States) or

admittedly did acknowledge the fact that the respective equity and debt financing functions in LBO associations were not entirely compartmentalized from one another, noting that "[t]he buyout fund purchases most of the equity and *sometimes provides* debt financing." Jensen, *Eclipse*, *supra* note 25, at 18 (emphasis added). Promptly afterwards, however, Jensen appears to discount those risks based on the assurance that "[t]he LBO partnership bond their performance by investing their own resources and reputations in the transaction and taking the bulk of their compensation in the form of their compensation as a share in the [portfolio] companies' increased value," while in any event holding only a "little of the debt." *Id.* at 19.

92. KELLY, *supra* note 52, at 143.

93. This finding is especially concerning given that the Institutional Limited Partners' Association recommends, as its foremost "best practice" principle for GPs, that "[a]lignment of interest [between GPs and LPs] is best achieved when the GP's wealth creation is primarily derived from a percentage of the profits generated from the GP's substantial equity commitment to the partnership, after LP return requirements have been met." *See* INSTITUTIONAL LTD. PARTNERS ASS'N, ILPA PRINCIPLES 3.0: FOSTERING TRANSPARENCY, GOVERNANCE AND ALIGNMENT OF INTERESTS FOR GENERAL AND LIMITED PARTNERS 9 (2019), https://perma.cc/9FPF-53P3 [hereinafter ILPA].

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on an aggregate whole fund basis (as is typically the case in Europe).[94]

Many respondents further underscored the difficulty and degree of risk entailed for the GP in seeking to meet this threshold. They told the Authors that such risk should not be underestimated, especially in relation to the less onerous method of calculating public equity fund managers' compensation. The latter agents have traditionally been compensated by reference to the total value of funds under management irrespective of the absolute level of return generated by the fund over the relevant period.[95]

In contrast to carried interest, management fees are typically perceived as the "deadweight" component of GP compensation from a performance-incentive perspective. As such, there is an ensuing risk of misalignment between GP and LP interests (in financial economics parlance, "agency costs") where annual management fee levels are excessive, at least in relation to corresponding levels of carried interest taken by the GP. It was explained to the Authors how, as the typical size of larger buyout funds has inflated over the past two decades from hundred-millions to multi-billion scale, management fees have, in turn, increasingly transitioned from a cost-covering cushion into a core GP profit source in their own right.[96]

B. Heightened Attractiveness of Fee Revenues for Listed P.E. Firms

In the case of many larger (and especially multi-product) P.E. firms, there is a common belief that management fees have now become a more important revenue

94. *See supra* note 21 and accompanying text.

95. *See supra* note 22 and accompanying text.

96. In response to the above charge that decreasing carry-to-fee compensation ratios are a source of GP/LP agency costs, it might be countered that such a claim (erroneously) assumes all carried interest generated from a successful fund liquidation or portfolio company exit accrues to the relevant GP firm as a whole, as opposed to its individual partners or other investment professionals. Within most P.E. firms in practice, though, the greater share of carried interest will tend to go to the individual executives involved in the relevant fund and/or deal, with only a minority accruing collectively to the firm (or management company) itself. Accordingly, since those receiving most of the carry (i.e., the relevant individual executives of the GP) are distinct from the principal beneficiary of ongoing fee streams (i.e., the P.E. firm itself), it would seem there is no reason to expect increased fee levels from MPSs (at firm-wide level) to undermine continuing executive incentives to ensure optimal value creation at fund and/or portfolio company level. However, in practice, there is often still a significant degree of overlap between carry and fee recipients insofar as: (1) a material (albeit minority) proportion of carry at least continues to accrue to the P.E. firm itself (in addition to its relevant individual executives), and (2) the individual executives of the firm entitled to receive carry on any fund or deal simultaneously have a material proprietary interest in the overall P.E. firm itself, for instance by virtue of being partners therein or significant shareholders of its management company. On inter-partner profit-sharing practices within P.E. firms, see Victoria Ivashina & Josh Lerner, *Pay Now or Pay Later? The Economics Within the Private Equity Partnership*, 131 J. FIN. ECON. 61 (2019).

stream than carried interest. This is especially so in the case of those P.E. firms (e.g., Blackstone, KKR, and Apollo) that have listed their management companies on public markets, where regular and periodic management fees typically constitute a more stable and predictable source of quarterly earnings growth than the relatively irregular, episodic, and variable nature of carried interest payments that depend on terminal dissolution of the relevant fund or asset for their realization.

Because of these developments, GPs who fail to meet the requisite hurdle rate of return to earn carried interest on any fund can often still earn significant profits on their annual management fees alone. [97] Moreover, since management fees are calculated by reference to funds under management rather than overall returns, there is a natural incentive for GPs to seek to maximize their aggregate volume of funds under management by utilizing drawdown facilities that permit them to make demands on existing LPs to release additional funds. In terms of prevailing incentives, the outcome could arguably be described in terms of a "heads I win, tails you lose" scenario for GPs vis-à-vis LPs.

It is noteworthy that, at least in the case of larger multi-product GPs, prevailing carry-to-fee ratios have increasingly drifted towards the 50:50 level or, in some cases, have even comprised management fees as the bigger of the two income generators.[98] This is a particular risk in cases where the GP's management company is a publicly listed entity, in view of the heightened stock market pressure it faces to maintain its periodic net income from fee streams at a consistently high level.[99]

This can in turn encourage an "asset-gathering" mentality whereby the relevant GP continually seeks to increase the scale and scope of its fund management activities to maximize its range and variety of potential fee streams,[100] potentially at the expense

97. As one commentator explains, "investors can't get comfortable putting a value on carried interest, despite its outsized profitability for the managers and, at least theoretically, the shareholders of the firm . . . [whereas t]he fees from managing a fund-of-funds are much more predictable and therefore more attractive for public investors." *See also* KELLY, *supra* note 52, at 195-96.

98. Interestingly, research over a decade ago demonstrated that, factoring in the time value of money (which discounts net present value of deferred carried interest payments relative to current fee payments), this ratio has in many cases been as high as 67:33 on the side of fees over carry. *See* Andrew Metrick & Ayako Yasuda, *The Economics of Private Equity Funds*, 23 REV. FIN. STUD. 2303 (2010). The Authors are grateful to Josh Lerner for alerting them to this important source.

99. In this regard, it has been remarked how "Blackstone's experience as a public company . . . underscored investors' desire for predictable streams of income and smoother trajectories for the overall profits." *See* KELLY, *supra* note 52, at 31.

100. It has notably been observed that "[Buyout fund] managers build on their prior experience by increasing the size of their funds faster than [venture capital fund] managers do," contributing to the conclusion that "the [buyout fund] business is much more scalable than the [venture capital fund] business." *See* Metrick & Yasuda, *supra* note 98, at 2336-37.

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of maximizing the capital value of its existing individual funds.[101] As one LP representative put it, "the game for the GP becomes about maximizing management company value rather than maximizing my carried interest outcome."[102]

C. Additional Economic Impacts of Fee-Heavy GP Compensation Structures

In fairness, Jensen himself was by no means blind to the possibility of such economic conflicts developing between GPs and LPs with the continuing growth of the P.E. buyout sector, and expressly acknowledged the fact (albeit seemingly as more of an ancillary afterthought than central concern). In the antepenultimate and penultimate paragraphs of his *Eclipse* article, Jensen described GP-LP conflicts as "some worrisome structural issues"[103] and made the following striking admission:

> I look with discomfort on the dangerous tendency of LBO partnerships, bolstered by their success, to take more of their compensation in front-end fees rather than in back-end profits earned through increased equity value. As management fees and the fees for completing deals get larger, the incentive to do deals, rather than good deals, also increases. Institutional investors (and the economy as a whole) are best served when the LBO partnership is the last member of the LBO Association to get paid and when the LBO partnership gets paid as a fraction of back-end value of the deals including losses.[104]

Whether Jensen anticipated either the scale or scope on which this problem would ultimately come to occur, though, is unclear.

The potentially damaging effect of the above predicament in obfuscating the incentives of P.E. firms to ensure generation of optimal client value from their funds is self-evident. One especially concerning ramification is the potential blunting of a GP's incentive to work towards resolving difficult strategic and/or financial challenges facing any of its portfolio companies. Empirical evidence demonstrates that P.E.

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101. One commentator has, somewhat aptly, described this phenomenon as "effectively an AUM arms race." *See also* KELLY, *supra* note 52, at 262.

102. Notably, CVC Capital Partners recently completed its long-awaited IPO on the Amsterdam Stock Exchange. *See supra* note 86. Following the previous example of its Swedish counterpart EQT in 2019, CVC's listing vehicle is a separate entity from the main firm partnership, which will receive the latter's management fees and only a small proportion of its performance-based revenues. Meanwhile, the majority of CVC's performance-based revenues from successfully executed deals will accrue to the existing (unlisted) partnership and therefore not be shared with outside public investors. *See Why CVC Is Going Public Now*, FIN. TIMES (Oct. 18, 2023), https://perma.cc/H3TU-39SM.

103. Jensen, *Eclipse*, *supra* note 25, at 28.

104. *Id.*

owners, in general, are more likely to implement successful business restructurings compared to non-P.E. owners, and also that they tend to do so more efficiently than their non-P.E. counterparts.[105] However, if the GP's terminal incentive to carried interest figures less prominently in their overall compensation mix, they might consequently be inclined simply to cut their losses from a failing or struggling portfolio company. In such cases, the relevant company's eventual secondary market purchaser will be left to deal with any unresolved strategic, financial, or operational issues.[106]

More fundamentally, the "asset-gathering" trend on the part of larger-scale P.E. firms could be interpreted as a form of financial conglomeration. This is because the inherent constraints on P.E. firms' capacity for risk diversification at the level of buyout fund portfolios (due to the typical scale and illiquidity of funds' individual asset holdings) are arguably compensated for by the sponsor firm's diversification of its fee sources instead, which consequently acts as an effective buffer against unforeseen external shocks to the ongoing value of fund portfolio assets.[107]

IV. PRIVATE ORDERING RESPONSES TO GP/LP CONFLICTS ARISING FROM MPSS AND RELATED COMPENSATION STRUCTURES

A. *Strengths and Weaknesses of LP Private Ordering*

From a theoretical standpoint, Jensen's faith in private ordering as an effective check on GP/LP agency costs arising from MPSs initially appears well-founded. After all, individual P.E. firms do not operate in a competitive vacuum, but rather compete continuously for new pools of capital from outside, sophisticated institutional investors. Moreover, since there is no objectively optimal scale or structure of P.E. firm to suit all supply- or demand-side preferences, it is almost certain that GPs will continue to exist in a variety of shapes and sizes for at least the foreseeable future. Accordingly, it might reasonably be assumed that collective competition from typically smaller, monoline P.E. firms will be sufficient to keep GP/LP agency costs arising from MPSs in check within their larger, more diversified counterparts.

However, the abovementioned structural competitive advantages enjoyed by large-scale P.E. firms will likely constrain any such supply-side market pressures,

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105. *See*, *e.g.*, Edith S. Hotchkiss et al., *Private Equity and the Resolution of Financial Distress*, 10 REV. CORP. FIN. STUD. 694 (2021); Shai Bernstein et al., *Private Equity and Financial Fragility During the Crisis*, 32 REV. FIN. STUD. 1309 (2019).

106. On the traditional function of carried interest in eliminating or at least significantly mitigating this perverse incentive on the part of P.E. owners, see BAKER & SMITH, *supra* note 32, at 161-62.

107. On the corresponding risk-buffering function performed by industrial conglomerate structures in this regard, see Kaufman & Englander, *supra* note 53, at 57-58; John C. Coffee, Jr., *Shareholders Versus Managers: The Strain in the Corporate Web*, *in* KNIGHTS, RAIDERS, AND TARGETS: THE IMPACT OF THE HOSTILE TAKEOVER 77 (John C. Coffee, Jr. et al. eds., 1988).

especially in the presence of limited demand-side outlets for LPs' committed capital.[108] It is therefore likely that, notwithstanding the (limited) pressures of the surrounding capital market environment, significant GP/LP agency costs are likely to perpetuate within "big P.E." so long as they remain justified, on a cost-benefit analysis, by the corresponding economies of scale and scope from MPSs.[109] But simply because this predicament is likely to ensue in the absence of regulatory intervention does not in itself make it optimally efficient or necessarily more efficient than a regulatorily (as opposed to market) determined arrangement.[110] There is therefore cause for a degree of skepticism with the Jensenian position.

Indeed, contemporary academic commentators in general appear to place only limited faith in the capacity of private ordering by LPs to impose an effective check on the above types of GP/LP conflict cost arising from prevailing fund structures. Whilst the relatively small number of LPs in a typical P.E. fund (at least compared with the corresponding number of shareholders in a typical public company) would infer the capacity for collective governance action on their part,[111] this possibility has been discounted by commentators due to the purported "prisoner's dilemma" that LPs typically face in this situation.[112]

Accordingly, the widespread use today of "sidecar" (or side-letter) arrangements by larger and/or more influential LPs—who consequently have the relative bargaining power to negotiate individually with a GP for preferential deal and/or fund terms—has the effect of reducing the former group's individual incentives to work towards agreeing collectively beneficial deal and/or fund terms in the interests of the LPs as a general body.[113] Academic commentators have further attributed LPs' allegedly limited bargaining power over governance matters to the "FOMO" (i.e., fear-

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108. *See supra* Part II.F.

109. This conclusion is consistent with the general tenet of Jensenian agency theory that, in the presence of real-world transaction costs, there is purportedly a dynamic-equilibrium level of agency costs in any principal-agent relation that is greater than zero but marginally less than the ensuing efficiencies from vesting the relevant agent (instead of principal) with authority to lead on the relevant transaction. *See* Jensen & Meckling, *supra* note 27.

110. On the respective merits of market pricing mechanisms and extraneous (especially legal) institutions in allocating scarce resources to their highest-valued social uses, see Ronald H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960).

111. *See, e.g.*, Marco Da Rin & Ludovic Phalippou, *The Importance of Size in Private Equity: Evidence from a Survey of Limited Partners*, 31 J. FIN. INTERMEDIATION 64 (2017).

112. On this social-scientific notion generally, see Diego Ríos & Eleonora Cresto, *Prisoner's Dilemma, One Shot and Iterated*, *in* INTERNATIONAL ENCYCLOPEDIA OF THE SOCIAL & BEHAVIORAL SCIENCES 930 (James D. Wright ed., 2d ed. 2015). On the risk of its occurrence within inter-LP relations in the P.E. fund context, see Kastiel & Nili, *supra* note 39, at 1613-14.

113. *Id. See also* Elizabeth de Fontenay & Yaron Nili, *Side Letter Governance*, 100 WASH. U. L. REV. 907 (2023); Josh Lerner et al., *Investing Outside the Box: Evidence from Alternative Vehicles in Private Equity*, 143 J. FIN. ECON. 359 (2022).

of-missing-out) phenomenon,[114] whereby LPs frequently refrain from complaining to GPs about any perceived gaps in their contractual protection due to "their fear of exclusion from the GP's [current or future] funds if they bargain too aggressively."[115]

At least based on some of the anecdotal insights the Authors received from their discussions with market participants, sub-optimal carry-to-fee compensation ratios would appear to be a risk that at least the more sophisticated segments of the LP community are capable of monitoring effectively as a prelude to investing in any new P.E. fund. One major LP institution explained to the Authors how they will customarily look at the last three or four funds raised by the GP of a prospective P.E. fund to assess the percentage of that firm's recent income that has come from fee streams as opposed to annual carry. That LP earmarked a ratio of two-thirds to seventy percent carry against thirty percent to one-third fees as traditionally being indicative of a reasonably good alignment of GP and LP interests.

B. *The Consistency of the "2+20" GP Compensation Structure*

In view of the progressively greater importance of fixed fees in relation to performance-triggered carry for many multi-product P.E. firms, the Authors might arguably expect to see an ensuing shift in prevailing GP compensation structures: whether by GPs seeking to increase the fixed fee component of their compensation ratio, or by LPs pressuring for an increased carry percentage to counteract such a trend.

One curious aspect of P.E. sector compensation practices is the fact that the GP's basic "2+20" compensation structure remains constant, on the surface of the relevant transaction at least.[116] That is to say: the GP will be entitled under the relevant limited partnership agreement to (1) 20% of absolute returns generated by the fund on its investments, subject to those returns first surpassing an 8% hurdle rate, which is compounded annually;[117] and (2) a fixed annual management fee comprising 2% of the fund's aggregate value of AUM at the time.

For this reason, "2+20" was described to the Authors as a "remarkably resilient" feature of the international P.E. market, with one supply-side respondent remarking that the 20% carry level is "sort of fixed in stone, more or less" and another telling us that "it's the last thing you touch." A representative of a large GP firm, meanwhile,

114. On this social-scientific notion generally, see Marina Milyavskaya et al., *Fear of Missing Out: Prevalence, Dynamics, and Consequences of Experiencing FOMO*, 42 MOTIVATION & EMOTION 725 (2018).

115. Kastiel & Nili, *supra* note 39, at 1615. *See also* William W. Clayton, *The Private Equity Negotiation Myth*, 37 YALE J. ON REG. 67 (2020).

116. In a similar vein, investment banks have for a long time been well-known for their duality of uniformly prescribing fee grids on the one hand while being willing to grant tacit, ad hoc concessions and preferential terms to certain individually favored clients on the other hand. *See* WILLIAM D. COHAN, THE LAST TYCOONS: THE SECRET HISTORY OF LAZARD FRERES & CO. 90 (2008).

117. *See supra* notes 21, 94 and accompanying text.

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explained how "if we ever get challenged [by LPs] on fees, . . . we're always quite able to defend the levels of fees we charge based on our enormous cost base."

In the case of smaller firms working with a lower capital base, higher management fees in the region of as much as 2.5% will often be deemed necessary to cover infrastructure and overheads. This practice has been especially important in recent years given the more demanding expectations and norms in relation to P.E. firm infrastructure today compared to previous eras, with multiple partners, global offices, and functions such as legal compliance and anti-money laundering now becoming increasingly standard across the sector. However, carry levels will typically not vary across the GP/fund size range in the same way as management fees.

C. LPs' General Agnosticism in Relation to Fee Levels

The Authors were informed how especially large and influential LPs such as U.S. public sector pension funds are often able to exploit their market power to negotiate for lower fees than the sectoral norm.[118] But otherwise, management fee levels were generally not a significant concern at all amongst the supply-side community, and certainly not a typical deal breaker in determining an investor's choice of GP and/or fund for any investment.

Many respondents attributed the relative triviality of fee levels from an LP perspective to the extraordinarily large spread of potential returns on private equity investments amongst competing GPs and funds, whereby funds in the top and third performance quartiles can frequently produce rates of return as much as 2000 basis point (i.e., twenty percent) apart from each other, in contrast to traditional asset classes where the corresponding return spreads are typically more around the 200 basis point (i.e., two percent) mark (such that management fee levels take on relatively greater materiality within the overall return mix).[119] Consequently, as one supply-side respondent put it, "you're not going to take a cut price manager who's going to put you in the bottom quartile. It's just not worth it."[120]

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118. This trend has likewise been flagged up in recent academic literature, such as Kastiel and Nili's observation that, "[a]s investors can negotiate individualized benefits in the side letters outside of fund agreements, they have weak incentives to negotiate collective fund-wide protections and strong incentives to maximize their private benefits." Kastiel & Nili, *supra* note 39, at 1614. According to Kastiel and Nili, "[t]his conflict of interest among investors also arises when investors with significant bargaining power receive preferential benefits through co-investment opportunities, access to alternative investment vehicles with better returns, or unwritten 'gentlemen's agreements.'" *Id.*

119. *See generally* Josh Lerner et al., *Smart Institutions, Foolish Choices: The Limited Partner Performance Puzzle*, 62 J. FIN. 731 (2007).

120. The problem of extreme heterogeneity in relative P.E. fund returns profiles is arguably exacerbated by the tendency of institutional investors—and especially U.S. public sector pension funds—to evaluate competing investment options using past returns as a key expected determinant of projected future returns. On the latter tendency, see Aleksandar

However, some degree of cross-country variation was reported to the Authors in terms of LPs' prioritization of fees in relation to returns, with Australian superannuation ("Super") funds noted for being especially hostile to high managerial expense ratios.[121] Recent developments in the Australian market, though, would suggest that the traditional discomfort of Super funds with private equity fee structures is now receding to some extent.[122]

In interviews with market participants, the Authors found that supply-side respondents in general were less concerned with prevailing *levels* of fees and compensation taken by GPs and portfolio company managers than with fee and compensation *structures*, and the ensuing incentives and alignment of interests that these structures are prone to engender.[123] There was also a view expressed that, so long as LPs are given full and detailed information on fee, carry, and compensation structures prior to investing, the ensuing transaction costs can effectively be priced in advance as a component of LPs' a priori returns calculus.

Moreover, supply-side respondents in general seemed relatively unperturbed by the level of carried interest taken by P.E. firms, so long as rigorous hurdle rates were in place to ensure that returns generated were effectively shared with fund LPs. With regard to the different components of compensation charged by GPs to their LPs, meanwhile, levels of management fee taken by GPs understandably tended to be a much more significant concern for LPs than corresponding levels of carried interest.

D. GPs' Scope to Implement Tacit ("Stealth") Carry Increases

Admittedly, in the case of the very large "mega-firms," smaller management fees in the region of 1.0-1.5% are common,[124] given the typically much larger value of assets being managed compared to smaller GPs. At first sight, this trend towards lower

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Andonov & Joshua D. Rauh, *The Return Expectations of Public Pension Funds*, 35 REV. FIN. STUD. 3777 (2022).

121. One supply-side respondent spoke of Australian superannuation funds having placed an "immense focus" on different P.E. funds' fee and cost levels, which in some instances have proved "absolutely deal-breaking."

122. *See* Meredith Booth, *Super Funds Expected to Move Above $185 Billion in Private Equity Investments by 2025: BCG*, INV. MAG. (May 23, 2022), https://perma.cc/7T6B-2LPU.

123. One supply-side respondent even went so far as to say that they are taking a relatively relaxed view on the issue of management fees, believing that the potentially colossal levels of carried interest GPs tend to make from successful large-scale buyouts were simply "too big" to make the annual management fee a material behavioral influence on them by comparison. The Authors would stress, however, that this view was not shared by most other supply-side respondents.

124. In the case of KKR, a 1.5% management fee has been a constant of the firm's pricing model throughout its life, alongside a monitoring fee of up to $500,000 per portfolio company, a director services fee of $25,000 per partner/associate for serving on any portfolio company board, plus a 1% (of buyout value) arrangement fee per deal completion. *See* BAKER & SMITH, *supra* note 32, at 241 n.14; Kaufman & Englander, *supra* note 53, at 71.

management fees at the very top of the market might seem counter-intuitive, given the greater bargaining leverage that the larger buyout firms hold vis-à-vis their LPs relative to their smaller counterparts. Shouldn't the mega-firms be charging *higher*, instead of lower, than the "two percent fee plus twenty percent carry" sectoral norm in view of the relatively higher demand for their asset management services?

However, the reality is that larger buyout firms in effect *are* often able to charge higher than the standard market rate, at least insofar as their carried interest is concerned. But rather than doing so via a straight-line increase in the basic carry rate itself (e.g., from twenty percent to twenty-two percent), they will typically achieve a de facto carry increase in more tacit, nuanced, and potentially lucrative ways. For instance, instead of seeking to push up the percentage of fund capital gains over the hurdle rate of return that can be taken as carried interest, the GP might instead negotiate for a reduction in the hurdle rate itself below the eight percent sectoral norm.[125] Noteworthy examples of P.E. firms who have done this in the past include CVC Capital, which lowered the carry hurdle rate for its 2016 fund from eight percent to six percent; and Advent International, which removed the hurdle rate entirely for its 2015 fund while still managing to raise $13 billion for it.[126]

Another potential way of effecting tacit GP compensation increases is by keeping both the basic carry percentage and hurdle rate constant but instead negotiating for a relatively generous "ratchet" on the basic twenty percent carry above the eight percent hurdle rate. Accordingly, the percentage of fund capital gains accruing to the GP as carry progressively increases (above the twenty percent floor rate) the more those

125. It should be noted that, since a GP's twenty percent carried interest entitlement—once successfully activated—is typically applied from zero percent returns upwards (rather than just from the 8% hurdle upwards), lowering the carry rate will not (contrary to first appearance) enable the GP to charge carried interest over a larger spread of returns. However, it will still have the significant benefit (to the GP at least) of enabling the GP's carry entitlement to be activated earlier and in accordance with a lower minimum performance threshold.

126. Javier Espinoza, *CVC Tightens Fundraising Terms After Strong Demand for New Fund*, FIN. TIMES (Dec. 19, 2016), https://perma.cc/UX6E-QWTY. There is an ongoing debate in the P.E. sector as to whether hurdle rates should rise or fall with prevailing interest rates. On one view, hurdle rates should arguably rise to reflect the higher opportunity cost of capital (and especially sovereign debt) in a high interest rate environment. On the other hand, hurdle rates should arguably fall in a high interest rate environment to ensure their achievement remains realistic in a more challenging macro-economic climate, otherwise their incentivizing effect may be negated. While there is no clear and definite answer to this question yet, current market practice suggests that the latter practice is considerably more common. Of course, in the case of *debt* funds run by P.E. firms, the opposite problem occurs whereby higher interest rates create pressure from LPs for the *lowering* of prevailing hurdle rates to prevent them from becoming too easy to meet. *See* Adam Le, *Are Hurdle Rates Too High for the Current Environment?*, PRIV. EQUITY INT'L (Nov. 9, 2023), https://perma.cc/4CJ9-ZDFZ.

gains exceed the eight percent hurdle rate of return by.[127]

E. GPs' Scope to Implement Tacit ("Stealth") Fee Discounts for Certain LPs

In any event, even to the extent any LPs *are* materially dissatisfied with existing GP fee and/or carry levels, their bargaining power in seeking to negotiate reduced percentages on those key particulars is likely to be severely restricted. This is especially so where there exists a significant surplus of supply over demand for investment capital across the sector. While this does not mean some element of flexibility on GP compensation is necessarily absent for especially influential or savvy LPs, such wiggle-room will almost always be created by recourse to particulars other than those on the GP's core fee/carry term sheet.

For example, a de facto fee reduction for a particular LP might be achieved indirectly by granting them (typically no-fee) co-investor status with respect to one or more investee companies, as an adjunct to their status as a conventional (fee-paying) fund LP. Indeed, it has been reported that, amidst the general slump in global deal volumes and values that has taken place in the current (at time of writing) market downturn, the popularity of co-investment arrangements (at least from the GP side) has increased due to the greater willingness of GPs to grant such dispensations to certain LPs in the face of ongoing capital-raising challenges, especially in the mid-market segment.[128]

Alternatively, that LP might be permitted to invest a portion of their committed capital to a more favorably priced sidecar product alongside their standard-term fund investment. The Authors also heard reports from supply-side respondents about the widespread use by GPs of differential fee structures including exclusive "fee breaks" for those LPs making an especially large capital commitment, which—in the case of larger-scale buyouts—will typically be in the multi-billion range. Such preferential side-deals are not offered to smaller LPs (in larger-scale buyouts, this will usually mean those committing capital below the half-billion level) who consequently lack the same degree of capital market presence and bargaining power.[129]

127. On GPs' use of ratcheted carry structures generally, see Nathan Williams, *Shift in Carry Models is 'Complicating' Fund Comparisons*, PRIV. EQUITY INT'L (Mar. 6, 2018), https://perma.cc/PT6R-M628.

128. *See* Amy Carroll & Carmela Mendoza, *Roundtable: The Future of Co-Investment*, PRIV. EQUITY INT'L (Oct. 2, 2023), https://perma.cc/KL5D-WA2B. In the United States at least, there have also been reported instances of transactional lawyers working on P.E. deals being granted co-investor status as an effective supplement to their fee-based compensation in relation to some deals. *See* Will Louch, *Kirkland & Ellis: Is It Party Over for the World's Most Profitable Law Firm?* FIN. TIMES (Dec. 11, 2023), https://perma.cc/Q6UV-4Z9X.

129. This is notwithstanding the Institutional Limited Partners' Association's "best practice" recommendation to the effect that "[d]ecisions made by the GP, including management of conflicts of interest, should take into account the benefit to the partnership as a whole rather than to the sole or disproportionate benefit of the GP, affiliates *or a subset of investors*

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From a GP perspective, the advantage of such ad hoc arrangements is that they enable certain large or influential LPs' demands to be catered for whilst, at the same time, ensuring that no individual exception is made (formally at least) to the GP's core "2+20" centered compensation term sheet. In this way, any potential floodgates problem that might otherwise have arisen from the occasional variation of the GP's formal term sheet is effectively forestalled.

At the same time, though, the tacit and undisclosed nature of such discriminatory fee arrangements certainly has not gone unrecognized amongst LPs more broadly. Indeed, one LP representative, when questioned by the Authors on what they regard to be their most prevalent informational concern in relation to the P.E. sector, replied that in terms of alignment of incentives between GPs and differently situated LPs, "there's a lot of stuff that goes on in terms of the GP and its economic arrangements that remains invisible to the LP community."[130]

V. THE (MODEST) CASE FOR A POST-JENSENIAN THEORIZATION OF P.E.

In the above analysis, the Authors have sought to track the changing dynamics of the central agency costs problem in relation to P.E.—from a perceived intra-company owner-manager conflict to an intra-fund GP/LP (and, to a lesser extent, LP/LP) conflict. The Authors have also demonstrated how, in parallel with those changing dynamics, there has correspondingly been an evolution in the range and sophistication of market-driven, private ordering responses to the new landscape.

However, while market practice has been typically quick to move with the times, academic theorizing has by contrast been characteristically slow, such that the now-largely outmoded, 1980s-inspired Jensenian model of P.E. remains largely dominant

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in the partnership." *See* ILPA, *supra* note 93, at 9 (emphasis added).

130. However, such investor concerns have not gone unheeded by regulators, as the SEC's (recently vacated) Preferential Treatment Rule demonstrated. This rule sought to prohibit GPs from providing preferential redemption rights or portfolio information to any specific LP(s) on a selective or exclusionary basis where the relevant GP "reasonably expects [such preferential treatment] would have a material, negative effect on other investors." Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, 88 Fed. Reg. 63206, 63212 (Sept. 14, 2023) [hereinafter SEC Attempt]. In any event, the GP would have been required to disclose any preferential arrangements with specific LPs to a fund's LP body as a whole. The proposed Preferential Treatment Rule was due to be supplemented by a further prohibition on all non-pro-rata charges or allocations amongst a fund's LPs, such as fee breaks to favored investors, unless any such arrangements are disclosed to all LPs and deemed to be fair and equitable. *See id.* at 63267. However, as noted above, the SEC's proposed Rule was recently (in June 2024) vacated by the U.S. Court of Appeals for the Fifth Circuit under the Administrative Procedure Act, essentially on the basis that the SEC exceeded its statutory authority in seeking to promulgate the suite of reforms of which this Rule formed part. *See* Nat'l Ass'n of Priv. Fund Managers v. SEC, 103 F.4th 1097, 1114 (5th Cir. 2024); *5th Circuit Strikes Down Private Fund Advisers Rules*, WHITE & CASE LLP (June 6, 2024), https://perma.cc/QR42-4Q59.

on a conceptual level today. Accordingly, the Authors believe that the time is now ripe for shifting towards a new, post-Jensenian theoretical paradigm of P.E., which is both cognizant of and responsive to today's markedly different organizational climate and the more latent but complex agency cost challenges it presents.

Contrary to the dominant theoretical model of P.E. in law and finance theory, the agency costs problem between corporate owners and managers is no longer the prevalent concern for the sector when it comes to alignment of key stakeholder interests.[131] Indeed, insofar as the vast majority of P.E. buyouts tend to be willingly supported (if not actively initiated) by prospective portfolio company managers, students and scholars of P.E. must correspondingly avoid the temptation to overplay the materiality of corporate ownership and control dynamics when seeking to problematize key aspects of the sector.

That is not to say agency costs problems are absent from P.E. today, or that the traditional Jensenian problem has effectively been "solved." Rather, in the manner of someone who plugs a bathtub crack only to see intensified water leakage elsewhere, Jensen's classical agency costs problem has merely been displaced or repositioned elsewhere in the proverbial P.E. basin. Accordingly, in place of the traditional owner-manager conflict at the heart of Jensenian agency costs theory, there is now a more nuanced and context-specific GP-LP conflict or, in some cases (e.g., selective co-investment and/or sidecar arrangements between GPs and preferred individual LPs), an inter-LP conflict.

However, far from "disproving" or otherwise undermining Jensen's classical agency costs rationalization of P.E. buyouts, this contemporary landscape only validates Jensen's additional cautionary words back in 1989 about the danger of conflicts of interest developing elsewhere in the P.E. relational mix.[132] Therefore, whilst the Authors have argued in this Article for shifting to a post-Jensenian rationalization of P.E., it may legitimately be countered that what is really being proposed is just a more thoroughgoing reapplication of the self-same theoretical model.

In the same way P.E. buyouts were cast by Jensen as a market-propelled mitigant of the classical ownership-control conflict in widely held corporations, the abovementioned LP private ordering mechanisms can be understood as market-driven antidotes to contemporary principal-agent (and/or principal-principal)[133] conflicts in the P.E. domain. To adopt a manufacturing analogy, this suggests that the (factual) inputs and outputs may well have evolved but the underlying (conceptual)

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131. *See generally* Rosemary Batt & Eileen Appelbaum, *The Agency Costs of Private Equity: Why Do Limited Partners Still Invest?*, 35 ACAD. MGMT. PERSP. 45 (2021); Christian Figge et al., *The GP-LP Conflict in Private Equity Funds Revisited: The Impact of Fund-Level Considerations on the Divestment Decision* (Ctr. for Entrepreneurial & Fin. Stud. Working Paper, 2012), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2051441.

132. *See supra* Part II.C.

133. On principal-agent and principal-principal problems in law and finance scholarship generally, see REINIER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 1-48 (3d ed. 2017).

machinery functions in fundamentally the same way as always.

The Authors do not claim that prior theory is incapable of explaining or making sense of the subject matter at hand. Rather, it is the Authors' belief that Jensenian agency costs theory, like any truly revolutionary science,[134] has the proven conceptual dynamism and malleability to make sense of evolving factual phenomena far beyond its own place and time. Accordingly, this Article sought to reinvigorate Jensen's still-valid 1980s intellectual technology for the more complex and convoluted world we now find ourselves in.

The extent to which internal-market, as opposed to external-regulatory, measures are sufficient to tackle the complex agency problems arising from MPSs remains a live issue for future research. On the one hand, the Authors would strongly discourage placing a priori faith in private ordering mechanisms on either side of the typical GP/LP relation to function as an effective constraint on GP/LP (or LP/LP) agency costs arising from MPSs. On the other hand, they would contest with equal strength the countervailing view that voluntary contractual and structural responses are inapposite in the absence of robust regulatory constraints on GP/LP (or LP/LP) agency costs.

As in any real-world transactional context, the challenge is not to eliminate agency costs completely, but rather to ensure they are dealt with in a way that is conducive to optimizing the attendant transactional cost savings from using complex economic-organizational structures. The Authors would therefore recommend that prospective reformers exercise a degree of caution in assessing whether to supplant the P.E. sector's market-responsive, self-regulating dynamic and the sophisticated array of private ordering mechanisms that it will continue to generate.

VI. CONCLUSION

In 1989, Michael Jensen anticipated that P.E. ownership could ultimately come to displace public stock markets as the principal medium for financing and governing mature business corporations.[135] Judging from the empirical evidence at least, Jensen's prediction may well not have been as far-fetched as it first seemed. From a high point of over 8,000 in the mid-to-late 1990s, the number of companies listed on major U.S. stock markets had by 2020 fallen to a low of less than half that figure. In the U.K., meanwhile, the number of domestically listed companies fell from a high of over 4,000 in the mid-to-late 1960s to a low of just over 1,000 by 2022.[136]

Notwithstanding the above trend, two decades after Jensen's landmark *Harvard*

134. *See generally* THOMAS S. KUHN, THE STRUCTURE OF SCIENTIFIC REVOLUTIONS (1962).

135. *See* Jensen, *Eclipse*, *supra* note 25.

136. *See* Emma Charlton, *The Global Supply of Equities Is Shrinking — Here's What You Need to Know*, WORLD ECON. F. (Apr. 24, 2024), https://perma.cc/R45K-FHKJ.

Business Review article,[137] two leading legal scholars contrarily predicted "the eclipse of private equity" at the hands of the reinvigorated and robust public corporation.[138] Yet as compelling and provocative as both the above visions may have been, the reality has proved rather more mundane.

With the benefit of hindsight, it is now known that both private equity and the public corporation remain alive and well. Moreover, all present signs are that they will continue to do so for at least the foreseeable future. Like any longstanding economic or social institution, both of the above phenomena owe their persistence[139] principally to their dynamism, in the sense of being able to adapt to a constantly changing environment without losing track of the core characteristics and qualities that make them what they are.[140] However, whereas prevailing academic theorizations of the corporation have tended to oscillate radically over time,[141] the dominant conceptualization of P.E. within law and finance scholarship has remained constant. This Article identified this as a problem that needs to be dealt with.

Under economic pressure to diversify in scope, exploit administrative efficiencies, and stabilize revenue streams, big P.E. has progressively replaced the traditional monoline corporate buyout platform with the much more complex and multifaceted MPS. However, the resultant multiplicity of product-linked fee streams has increasingly drawn a wedge between on the one hand, the interest of GPs (and especially those GPs whose management companies are publicly listed) in ensuring the stability and predictability of periodic revenue sources; and, on the other hand, the continuing interest of LPs in ensuring maximization of ultimate capital gains from P.E. fund assets. The effect of these developments has been to reposition the classical Jensenian agency problem from the (lower) intra-portfolio-company level to the (higher) P.E. fund level, which leads in turn to questions about the most appropriate market-driven or regulatory methods for mitigating the ensuing agency costs.

So far, the signs are that reasonably effective LP private ordering mechanisms have developed (and will likely continue to develop) in response to the contemporary agency costs landscape, although significant concerns remain in relation to prevailing GP compensation practices and ensuing performance-incentive challenges for LPs.[142]

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137. *See* Jensen, *Eclipse*, *supra* note 25.

138. *See* Brian Cheffins & John Armour, *The Eclipse of Private Equity*, 33 DEL. J. CORP. L. 1 (2008).

139. For a relatively early (and, with the benefit of hindsight, correct) academic assertion of P.E.'s inherently persistent and non-fad-like nature, see Steven N. Kaplan, *The Staying Power of Leveraged Buyouts*, 6 J. APPLIED CORP. FIN. 15 (1993).

140. For a comprehensive rationalization of the corporation as a dynamic technology capable of continual adaptive re-calibration, see CHRISTOPHER M. BRUNER, THE CORPORATION AS TECHNOLOGY: RE-CALIBRATING CORPORATE GOVERNANCE FOR A SUSTAINABLE FUTURE (2022).

141. *See* C.A. Harwell Wells, *The Cycles of Corporate Social Responsibility: An Historical Retrospective for the Twenty-First Century*, 51 U. KAN. L. REV. 77 (2002); Marc T. Moore & Antoine Rebérioux, *Revitalizing the Institutional Roots of Anglo-American Corporate Governance*, 40 ECON. & SOC'Y 84 (2011).

142. *See supra* Part IV.

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Nonetheless, the Authors believe that, at moments like this, overzealous reformers should be wary of throwing out the proverbial baby with the bathwater.[143] After all, P.E. as a social phenomenon owes its longevity to its dynamism and ability to move with the times in response to evolving challenges.[144]

The same can be said of Jensenian agency costs theory, which remains a popular intellectual reference point today in numerous disciplinary and factual domains. Indeed, just as the Blackstones of this world adapted the basic 1970s monoline LBO firm to a new scale and scope of sophistication in later decades, the Authors hope to do the same here with Michael Jensen's pathbreaking thinking on private equity. In so doing, the Authors hope to help ensure that whilst the inventor may sadly no longer be with us, his invention unquestionably lives on for generations to come.

143. For an example of a recent (albeit ultimately unsuccessful) attempted regulatory reform measure in relation to the P.E. sector, see SEC Attempt, *supra* note 130.

144. *See* NILS RODE & VERITY HOWELLS, PRIVATE EQUITY'S RESILIENCE DURING MAJOR CRISES OF THE LAST 25 YEARS (Oct. 15, 2024), https://perma.cc/R8ZE-AL3V; Hrvoje Kurtović & Garen Markarian, *Tail Risks and Private Equity Performance*, 75 J. EMPIRICAL FIN. 1 (2024).