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Private markets: A slower era

McKinsey Global Private Markets Review 2024

March 2024

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Executive summary

Welcome to the 2024 edition of McKinsey's annual review of private markets investing. Our ongoing research on the industry's dynamics and performance has revealed several insights, including the following trends:

Macroeconomic challenges continued. If 2022 was a tale of two halves, with robust fundraising and deal activity in the first six months followed by a slowdown in the second half, then 2023 might be considered a tale of one whole. Macroeconomic headwinds persisted throughout the year, with rising financing costs and an uncertain growth outlook taking a toll on private markets. Full-year fundraising continued to decline from 2021's lofty peak, weighed down by the "denominator effect" that persisted in part due to a less active deal market. Managers largely held onto assets to avoid selling in a lower-multiple environment, fueling an activity-dampening cycle in which distribution-starved limited partners (LPs) reined in new commitments.

Performance in most private asset classes remained below historical averages for a second consecutive year. Decade-long tailwinds from low and falling interest rates and consistently expanding multiples seem to be things of the past. As private market managers look to boost performance in this new era of investing, a deeper focus on revenue growth and margin expansion will be needed now more than ever.

Global fundraising contracted. Fundraising fell 22 percent across private market asset classes globally to just over $1 trillion, as of year-end reported data—the lowest total since 2017. Fundraising in North America, a rare bright spot in 2022, declined in line with global totals, while in Europe, fundraising proved most resilient, falling just 3 percent. In Asia, fundraising fell precipitously and now sits 72 percent below the region's 2018 peak.

Despite difficult fundraising conditions, headwinds did not affect all strategies or managers equally. Private equity (PE) buyout strategies posted their best fundraising year ever, and larger managers and vehicles also fared well, continuing the prior year's trend toward greater fundraising concentration.

The numerator effect persisted. Despite a marked recovery in the denominator—the 1,000 largest US retirement funds grew 7 percent in the year ending September 2023 after falling 14 percent the prior year,[1] for example—many LPs remain overexposed to private markets relative to their target allocations. LPs started 2023 overweight: according to analysis from CEM Benchmarking, average allocations across PE, infrastructure, and real estate were at or above target allocations as of the beginning of the year. And the numerator grew throughout the year, as a lack of exits and rebounding valuations drove net asset values (NAVs) higher. While not all LPs strictly follow asset allocation targets, our analysis in partnership with global private markets firm StepStone Group suggests that an overallocation of just one percentage point can reduce planned commitments by as much as 10 to 12 percent per year for five years or more.

Despite these headwinds, recent surveys indicate that LPs remain broadly committed to private markets. In fact, the majority plan to maintain or increase allocations over the medium to long term.

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[1] "U.S. retirement plans recover half of 2022 losses amid no-show recession," *Pensions and Investments*, February 12, 2024.

Investors fled to known names and larger funds. Fundraising concentration reached its highest level in over a decade, as investors continued to shift new commitments in favor of the largest fund managers. The 25 most successful fundraisers collected 41 percent of aggregate commitments to closed-end funds (with the top five managers accounting for nearly half that total). Closed-end fundraising totals may understate the extent of concentration in the industry overall, as the largest managers also tend to be more successful in raising non-institutional capital.

While the largest funds grew even larger—the largest vehicles on record were raised in buyout, real estate, infrastructure, and private debt in 2023—smaller and newer funds struggled. Fewer than 1,700 funds of less than $1 billion were closed during the year, half as many as closed in 2022 and the fewest in any year since 2012. New manager formation also fell to the lowest level since 2012, with just 651 new firms launched in 2023.

Whether recent fundraising concentration and a spate of M&A activity signals the beginning of oft-rumored consolidation in the private markets remains uncertain, as a similar pattern developed in each of the last two fundraising downturns before giving way to renewed entrepreneurialism among general partners (GPs) and commitment diversification among LPs. Compared with how things played out in the last two downturns, perhaps this movie really *is* different, or perhaps we're watching a trilogy reusing a familiar plotline.

Dry powder inventory spiked (again). Private markets assets under management totaled $13.1 trillion as of June 30, 2023, and have grown nearly 20 percent per annum since 2018. Dry powder reserves—the amount of capital committed but not yet deployed—increased to $3.7 trillion, marking the ninth consecutive year of growth. Dry powder inventory—the amount of capital available to GPs expressed as a multiple of annual deployment—increased for the second consecutive year in PE, as new commitments continued to outpace deal activity. Inventory sat at 1.6 years in 2023, up markedly from the 0.9 years recorded at the end of 2021 but still within the historical range. NAV grew as well, largely driven by the reluctance of managers to exit positions and crystallize returns in a depressed multiple environment.

Decade-long tailwinds from low and falling interest rates and consistently expanding multiples seem to be things of the past.

Private equity strategies diverged. Buyout and venture capital, the two largest PE sub-asset classes, charted wildly different courses over the past 18 months. Buyout notched its highest fund-raising year ever in 2023, and its performance improved, with funds posting a (still paltry) 5 percent net internal rate of return through September 30. And although buyout deal volumes declined by 19 percent, 2023 was still the third-most-active year on record. In contrast, venture capital (VC) fundraising declined by nearly 60 percent, equaling its lowest total since 2015, and deal volume fell by 36 percent to the lowest level since 2019. VC funds returned −3 percent through September, posting negative returns for seven consecutive quarters. VC was the fastest-growing—as well as the highest-performing—PE strategy by a significant margin from 2010 to 2022, but investors appear to be reevaluating their approach in the current environment.

Private equity entry multiples contracted. PE buyout entry multiples declined by roughly one turn from 11.9 to 11.0 times EBITDA, slightly outpacing the decline in public market multiples (down from 12.1 to 11.3 times EBITDA), through the first nine months of 2023. For nearly a decade leading up to 2022, managers consistently sold assets into a higher-multiple environment than that in which they had bought those assets, providing a substantial performance tailwind for the industry. Nowhere has this been truer than in technology. After experiencing more than eight turns of multiple expansion from 2009 to 2021 (the most of any sector), technology multiples have declined by nearly three turns in the past two years, 50 percent more than in any other sector. Overall, roughly two-thirds of the total return for buyout deals that were entered in 2010 or later and exited in 2021 or before can be attributed to market multiple expansion and leverage. Now, with falling multiples and higher financing costs, revenue growth and margin expansion are taking center stage for GPs.

Real estate receded. Demand uncertainty, slowing rent growth, and elevated financing costs drove cap rates higher and made price discovery challenging, all of which weighed on deal volume, fundraising, and investment performance. Global closed-end fundraising declined 34 percent year over year, and funds returned −4 percent in the first nine months of the year, losing money for the first time since the 2007–08 global financial crisis. Capital shifted away from core and core-plus strategies as investors sought liquidity via redemptions in open-end vehicles, from which net outflows reached their highest level in at least two decades. Opportunistic strategies benefited from this shift, with investors focusing on capital appreciation over income generation in a market where alternative sources of yield have grown more attractive. Rising interest rates widened bid–ask spreads and impaired deal volume across food groups, including in what were formerly hot sectors: multifamily and industrial.

About this report

McKinsey is the leading adviser to private markets firms, including private equity, real estate, private debt, and infrastructure firms, with a global practice substantially larger than any other firm. We are also the leading consultant partner to the institutional investors that allocate capital to private markets, such as pensions, insurance companies, sovereign wealth funds, endowments, foundations, and family offices.

This is the 2024 edition of our annual review of private markets.[1] To produce it, we have developed new analyses drawn from our long-running research on private markets, based on the industry's leading sources of data and in conjunction with StepStone Group and CEM Benchmarking.[2] We have also gathered insights from our colleagues around the world who work closely with the world's leading GPs and LPs.

We welcome your questions and suggestions at investing@mckinsey.com.

[1] We define private markets as closed-end funds investing in private equity, real estate, private debt, infrastructure, or natural resources, as well as related secondaries and funds of funds. We exclude hedge funds and, except where otherwise noted, publicly traded or open-end funds.

[2] All data for 2023 figures is based on reported numbers and will likely adjust as more figures continue to be reported. Performance data is as of September 30 for vintages 2000–2020, unless otherwise noted; AUM data is as of June 30; and fundraising data cover the full year 2023. All data for Asia excludes Australia and New Zealand unless otherwise noted.

Private debt pays dividends. Debt again proved to be the most resilient private asset class against a turbulent market backdrop. Fundraising declined just 13 percent, largely driven by lower commitments to direct lending strategies, for which a slower PE deal environment has made capital deployment challenging. The asset class also posted the highest returns among all private asset classes through September 30. Many private debt securities are tied to floating rates, which enhance returns in a rising-rate environment. Thus far, managers appear to have successfully navigated the rising incidence of default and distress exhibited across the broader leveraged lending market. Although direct lending deal volume declined from 2022, private lenders financed an all-time high 59 percent of leveraged buyout transactions last year and are now expanding into additional strategies to drive the next era of growth.

Infrastructure took a detour. After several years of robust growth and strong performance, infrastructure and natural resources fundraising declined by 53 percent to the lowest total since 2013. Supply-side timing is partially to blame: five of the seven largest infrastructure managers closed a flagship vehicle in 2021 or 2022, and none of those five held a final close last year. As in real estate, investors shied away from core and core-plus investments in a higher-yield environment. Yet there are reasons to believe infrastructure's growth will bounce back. Limited partners (LPs) surveyed by McKinsey remain bullish on their deployment to the asset class, and at least a dozen vehicles targeting more than $10 billion were actively fundraising as of the end of 2023. Multiple recent acquisitions of large infrastructure GPs by global multi-asset-class managers also indicate marketwide conviction in the asset class's potential.

Private markets still have work to do on diversity. Private markets firms are slowly improving their representation of females (up two percentage points over the prior year) and ethnic and racial minorities (up one percentage point). On some diversity metrics, including entry-level representation of women, private markets now compare favorably with corporate America. Yet broad-based parity remains elusive and too slow in the making. Ethnic, racial, and gender imbalances are particularly stark across more influential investing roles and senior positions. In fact, McKinsey's research reveals that, at the current pace, it would take several decades for private markets firms to reach gender parity at senior levels. Increasing representation across all levels will require managers to take fresh approaches to hiring, retention, and promotion.

Artificial intelligence generating excitement. The transformative potential of generative AI was perhaps 2023's hottest topic (beyond Taylor Swift). Private markets players are excited about the potential for the technology to optimize their approach to thesis generation, deal sourcing, investment due diligence, and portfolio performance, among other areas. While the technology is still nascent and few GPs can boast scaled implementations, pilot programs are already in flight across the industry, particularly within portfolio companies. Adoption seems nearly certain to accelerate throughout 2024.

1 Private markets in a slower era

If private markets investors entered 2023 hoping for a return to the heady days of 2021, they likely left the year disappointed. Many of the headwinds that emerged in the latter half of 2022 persisted throughout the year, pressuring fundraising, dealmaking, and performance. Inflation moderated somewhat over the course of the year but remained stubbornly elevated by recent historical standards. Interest rates started high and rose higher, increasing the cost of financing. A reinvigorated public equity market recovered most of 2022's losses but did little to resolve the valuation uncertainty private market investors have faced for the past 18 months.

Within private markets, the denominator effect remained in play, despite the public market recovery, as the numerator continued to expand. An activity-dampening cycle emerged: higher cost of capital and lower multiples limited the ability or willingness of general partners (GPs) to exit positions; fewer exits, coupled with continuing capital calls, pushed limited partner allocations higher, thereby limiting their ability or willingness to make new commitments. These conditions weighed on managers' ability to fundraise. Based on data reported as of year-end 2023, private markets fundraising fell 22 percent from the prior year to just over $1 trillion, the largest such drop since 2009.

The impact of the fundraising environment was not felt equally among GPs. Continuing a trend that emerged in 2022, and consistent with prior downturns in fundraising, LPs favored larger vehicles and the scaled GPs that typically manage them. Smaller and newer managers struggled, and the number of sub–$1 billion vehicles and new firm launches each declined to its lowest level in more than a decade.

Despite the decline in fundraising, private markets assets under management (AUM) continued to grow, increasing 12 percent to $13.1 trillion as of June 30, 2023. 2023 fundraising was still the sixth-highest annual haul on record, pushing dry powder higher, while the slowdown in deal making limited distributions.

Investment performance across private market asset classes fell short of historical averages. Private equity (PE) got back in the black but generated the lowest annual performance in the past 15 years, excluding 2022. Closed-end real estate produced negative returns for the first time since 2009, as capitalization (cap) rates expanded across sectors and rent growth dissipated in formerly hot sectors, including multifamily and industrial. The performance of infrastructure funds was less than half of its long-term average and even further below the double-digit returns generated in 2021 and 2022.

Private debt was the standout performer (if there was one), outperforming all other private asset classes and illustrating the asset class's counter-cyclical appeal.

Fundraising

Global private markets fundraising fell 22 percent year over year to $1.0 trillion, the lowest total since 2017 (Exhibit 1). Fundraising in every asset class and region declined from the prior year.

Exhibit 1

Private markets fundraising fell 22 percent in 2023.

Private markets fundraising,[1] 2023

			Asset class			
		Private markets	Private equity	Real estate	Private debt	Infrastructure and natural resources
North America	Total, $ billion	**681**	**424**	**84**	**117**	**55**
	2022–23, $ billion	–191	–83	–49	–20	–38
	YoY change, %	–22	–16	–37	–15	–41
Europe	Total, $ billion	**243**	**159**	**23**	**41**	**20**
	2022–23, $ billion	–8	58	–4	–18	–44
	YoY change, %	–3	57	–14	–31	–69
Asia	Total, $ billion	**79**	**54**	**15**	**9**	**2**
	2022–23, $ billion	–73	–56	–10	–2	–6
	YoY change, %	–48	–51	–41	–16	–74
Rest of world	Total, $ billion	**43**	**12**	**4**	**23**	**5**
	2022–23, $ billion	–30	–37	–2	13	–4
	YoY change, %	–41	–76	–38	132	–44
Global	Total, $ billion	**1,046**	**649**	**125**	**190**	**82**
	2022–23, $ billion	–302	–118	–65	–27	–91
	YoY change, %	–22	–15	–34	–13	–53

Note: Figures may not sum precisely because of rounding.
[1]Excludes secondaries, funds of funds, and co-investment vehicles. Reported figures only include funds that held final closes in CY 2023.
Source: Preqin

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On the heels of a record-setting 2022, fundraising in North America declined 22 percent in 2023 (Exhibit 2). North America–focused infrastructure and natural resources led the decline, falling 41 percent, followed by closed-end real estate, down 37 percent. PE and private debt fundraising in the region proved slightly more resilient in comparison, decreasing 16 percent and 15 percent, respectively.

In Europe, fundraising declined 3 percent to $243 billion. The region's apparent resilience last year is somewhat illusory, as fundraising in the region fell by 24 percent the prior year and has now declined 27 percent from the record high achieved in 2021. Fundraising in North America, in comparison, fell 20 percent over the two-year period. That said, fundraising for Europe-focused PE strategies was a bright spot in 2023, increasing 57 percent year over year to set a new record high for the region. Fundraising declined in all other asset classes.

Fundraising in Asia declined 48 percent to $79 billion, marking a 13-year low. The paltry haul in 2023 was 72 percent below 2018's $285 billion peak. A confluence of factors—including the ongoing influence of government regulations (such as asset management product regulations in 2018 and private fund regulations in 2023) that make it more difficult to raise capital—has contributed to the multiyear fundraising decline for Asia-focused funds broadly and particularly for China-focused funds. The fundraising decline was widespread across all asset classes, and fundraising in infrastructure and natural resources and PE each declined by more than 50 percent.

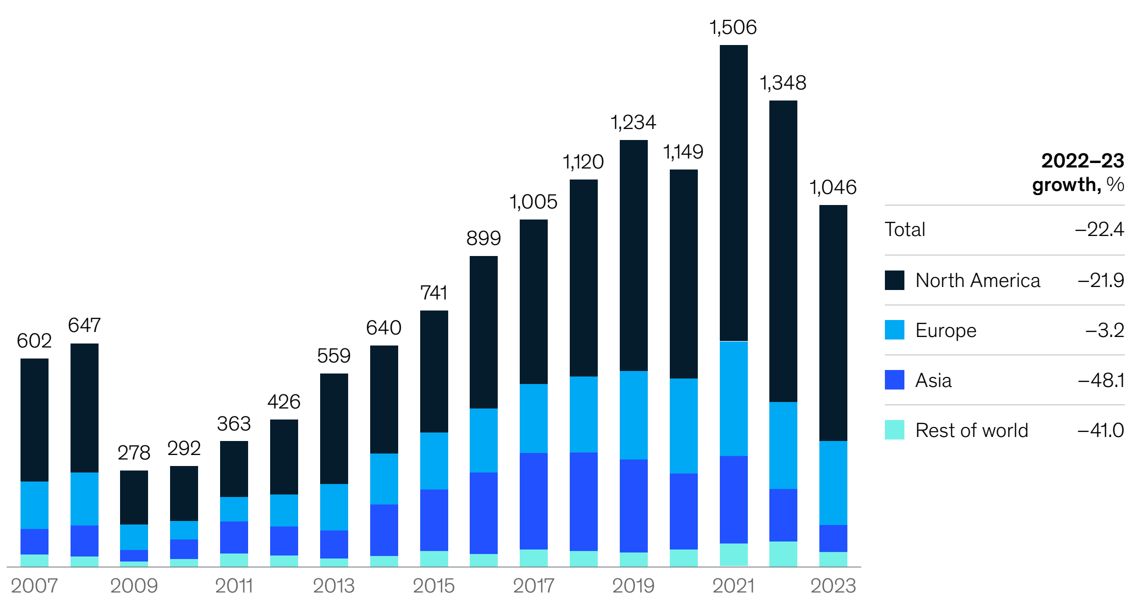
The numerator effect

Many institutional investors entered 2023 with current private markets allocations that exceeded target allocations. This phenomenon resulted, in part, from a sharp decline in the value of investors'

Exhibit 2

Fundraising declined in all regions.

Global private markets fundraising by region,[1] $ billion



[1]Includes closed-end funds in private equity, real estate, private debt, natural resources, and infrastructure. Excludes secondaries, funds of funds, and co-investment vehicles.
Source: Preqin

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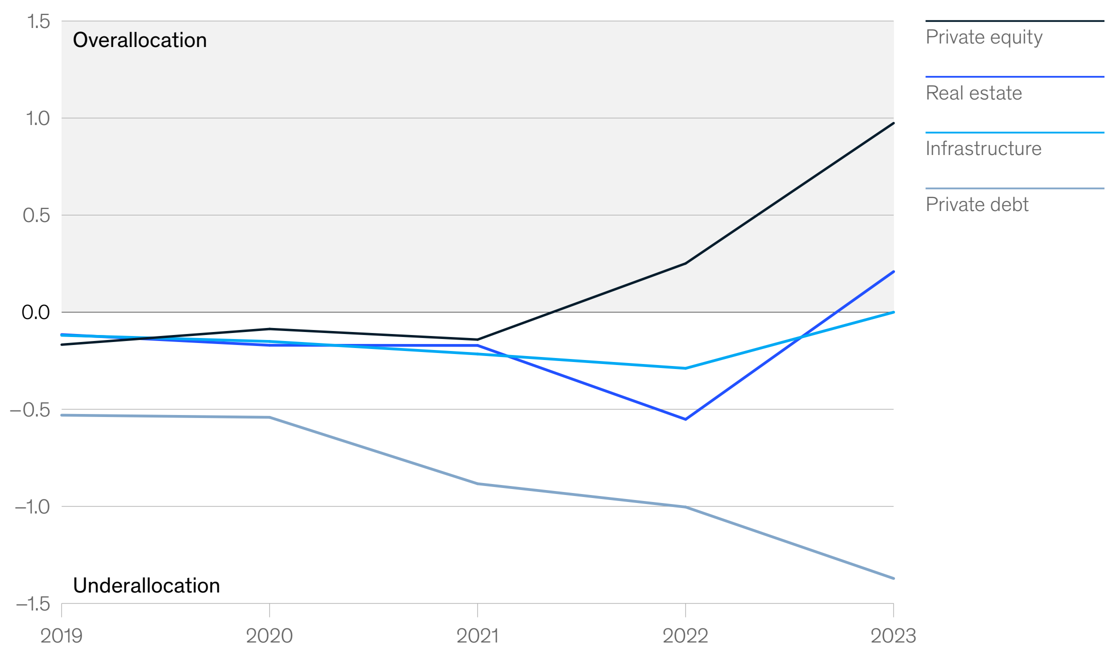
public market holdings in 2022, reducing the value of overall portfolios (the denominator) without a corresponding decline in private markets holdings (the numerator). This so-called denominator effect could be observed across asset classes: average allocations to PE, real estate, and infrastructure as of the beginning of 2023 matched or exceeded average target allocations (Exhibit 3). Only allocations to private debt—perhaps not coincidentally, the most resilient asset class in terms of 2023 fundraising—were below targets at the beginning of the year.

In 2023, the denominator recovered: the 1,000 largest US retirement funds grew 7 percent in the year ending September 2023 after falling 14 percent the prior year.[2] But many LPs remained overallocated to private markets due to growth in the numerator, that is, the net asset value in private markets. The net asset value of global private markets increased 10 percent year over year as of June 2023. NAV growth was exacerbated by continuing capital calls and fewer exits. In 2023, capital calls exceeded distributions by 80 percent—the largest relative difference since 2009.

Exhibit 3

Average allocations for private equity and real estate exceeded average target allocations in 2023.

Difference between effective and policy allocations by private markets asset class by year,[1] %



[1]Data as of the beginning of the year.
Source: CEM Benchmarking

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[2] "U.S. retirement plans recover half of 2022 losses amid no-show recession," *Pensions and Investments*, February 12, 2024.

Even seemingly small degrees of overallocation can have a substantial impact on future commitments for investors seeking to adhere to their asset allocation targets. For example, global private markets firm StepStone Group has determined that a 1 percent overweight position in PE today could reduce investors' planned commitments by as much as 12 percent annually over the next five years. This magnitude likely understates the true impact in today's market, as investors were largely underallocated before becoming overallocated in 2022. The analysis studied the difference in planned commitments that StepStone's proprietary pacing model would suggest for a hypothetical $100 billion institutional investor with a mature PE portfolio and a 10 percent target allocation (that is, $10 billion) between three different starting points in 2024:

1. *At weight (10 percent current allocation, equal to the target allocation).* The pacing model calls for nearly $2.7 billion in annual commitments on average over the next five years to maintain the 10 percent target.

2. *Overweight by one percentage point (11 percent current allocation).* The pacing model calls for approximately $2.4 billion on average, or $270 million (10 percent) *less* per year, to return to the 10 percent target.

3. *Underweight by one percentage point (9 percent actual allocation).* The pacing model calls for $3.1 billion on average, or $380 million (14 percent) *more* per year, to return to the 10 percent target.

The analysis suggests that fundraising headwinds may persist for several years, in the absence of meaningful deviations from the current trajectory, and relies on two key assumptions. The first is total portfolio (denominator) growth of 5.5 percent per year, which is in line with typical assumptions used for such modeling. The second is exit/distribution rates (which affect the size of the numerator) consistent with long-term market norms. If either assumption is proven to be materially incorrect—that is, if the denominator grows more quickly or the exit velocity exceeds historical averages—overallocation pressures may subside.

Though the denominator effect may weigh on short- and mid-term fundraising, the long-term outlook for capital formation remains intact as long as LPs' behavior matches their stated intent. For example, in a recent McKinsey survey of over 300 LPs globally,[3] 43 percent of respondents said they anticipate increasing their allocations to private markets over the next three years; only 22 percent said they expect to decrease allocations.

Concentration among large managers

Fundraising headwinds that persisted in 2023 affected managers unequally. Fundraising grew more concentrated among large managers in 2023, continuing a trend from the prior year and consistent with the capital rotation that also emerged in prior fundraising downturns. In 2023, the top 25 fund managers amassed 41 percent of all funds raised, the most since 2008 (Exhibit 4). The top ten managers alone captured 26 percent of fundraising. Not coincidentally, an outsized share of fundraising went to larger individual funds. GPs raised 36 funds larger than $5 billion in 2023, the second most on record, including the largest fund ever in each of private debt, real estate, infrastructure, and buyouts (Exhibit 5).

Smaller and newer managers struggled in this environment. Only 1,650 funds of less than $1 billion closed during the year, the fewest since 2012 and about half the number formed in 2022. Just 651 new firms launched last year, also the lowest such total since 2012. In what is typically an enormously entrepreneurial industry, venturing out on one's own was exceedingly difficult in 2023.

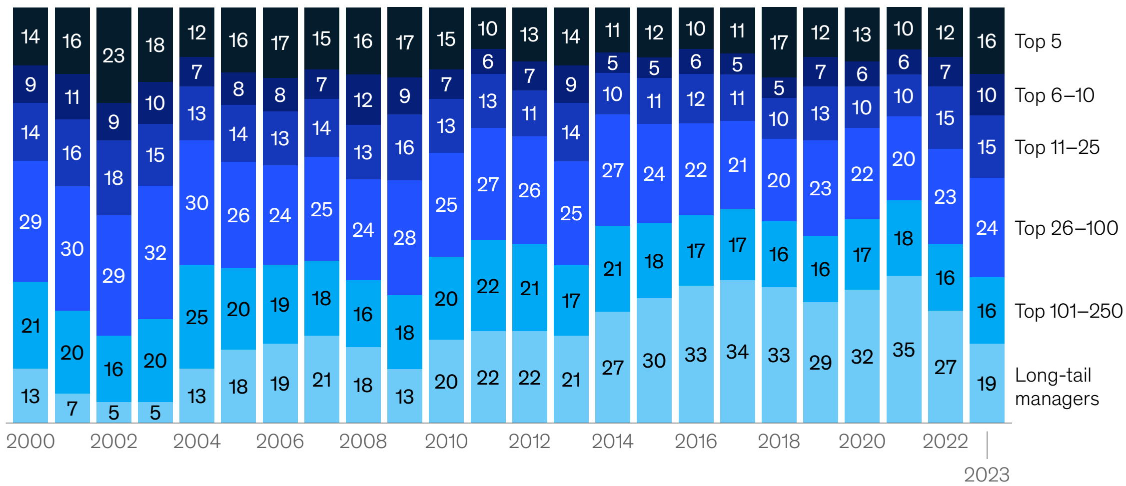
After a decade of relative consistency in private markets' industry structure, fundraising in the last two years has become more concentrated. However, concentration among larger managers has

[3] McKinsey GP-LP Private Markets survey, January 2024.

Exhibit 4

2023 had the highest concentration in fundraising in over a decade.

Share of private markets fundraising by year,[1] %



Note: Figures may not sum precisely because of rounding.
[1]Excludes secondaries, funds of funds, and co-investment vehicles.
Source: Preqin

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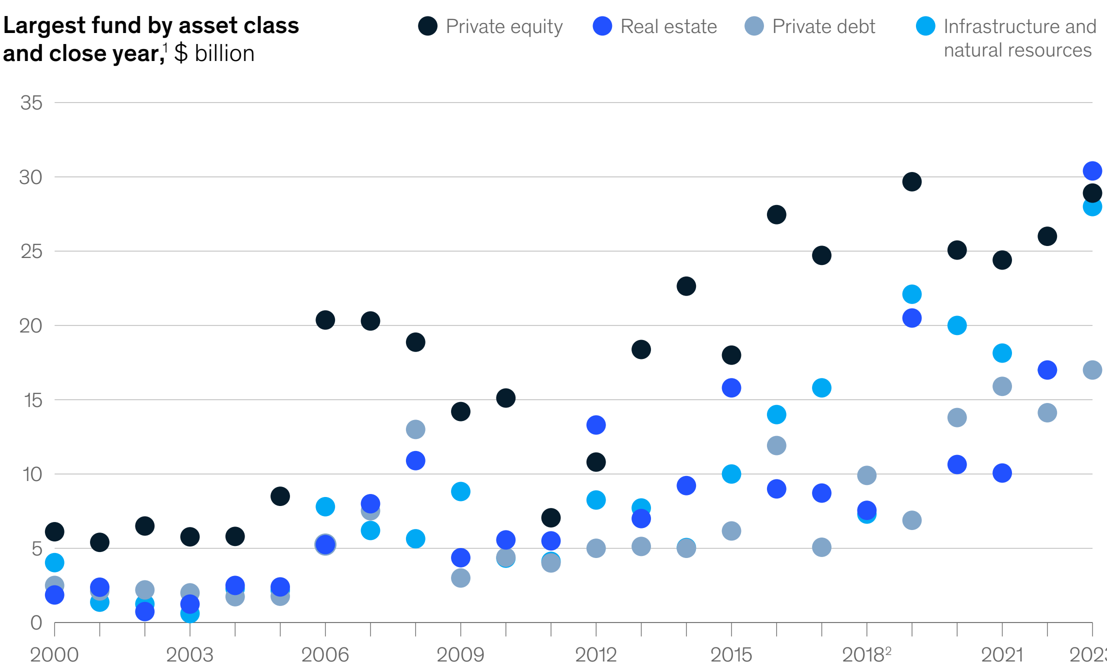
Exhibit 5

Real estate, private debt, and infrastructure raised their largest funds on record in 2023.

Largest fund by asset class and close year,[1] $ billion



[1]Excludes secondaries, funds of funds, and co-investment vehicles.
[2]For scale purposes, the chart excludes a $98.5 billion PE fund that closed in 2018.
Source: Preqin

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occurred—and subsequently reversed—in each of the last three fundraising downturns, suggesting that the current trend could be cyclical (that is, LPs favoring existing managers when shrinking total commitments) rather than secular (that is, permanent consolidation of institutional fundraising).

AUM

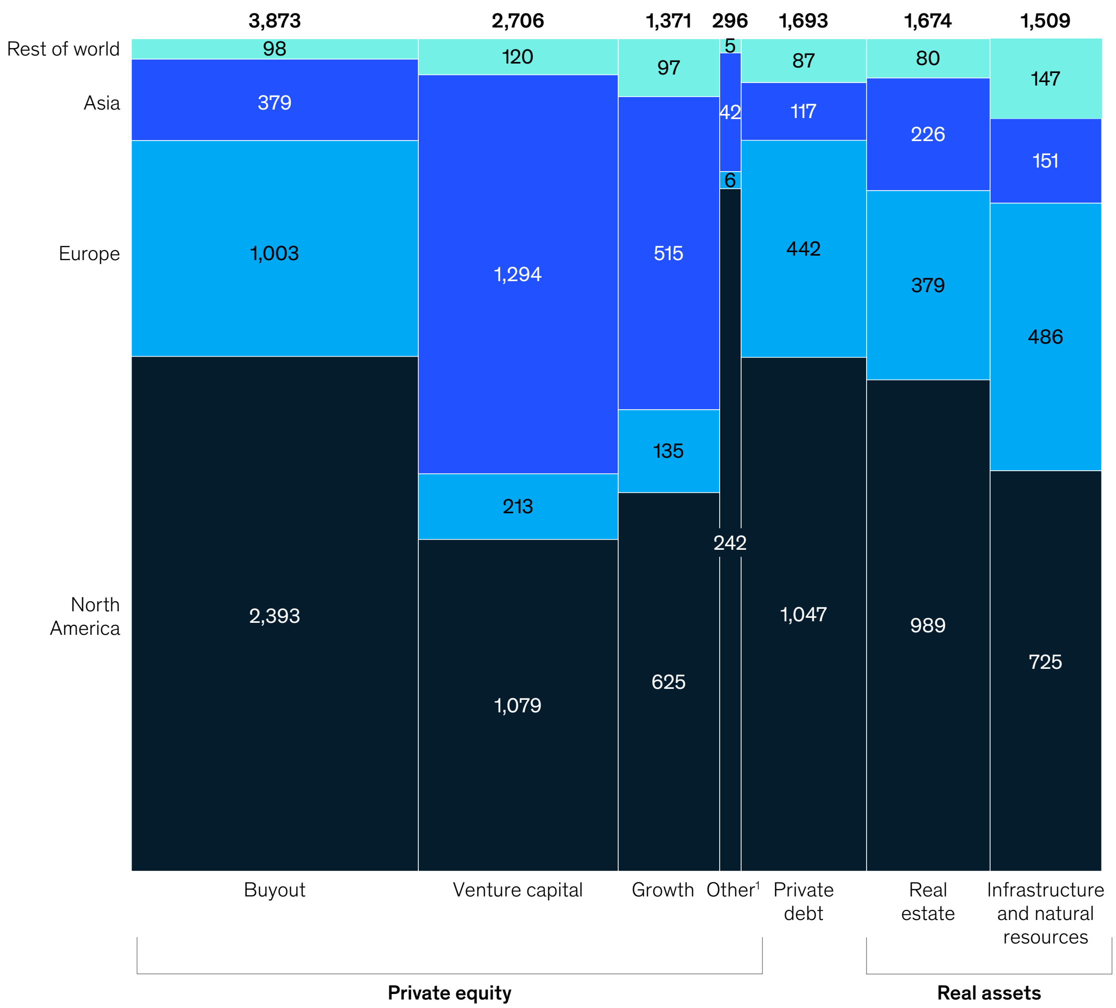
Private markets AUM totaled $13.1 trillion as of June 30, 2023 (Exhibit 6).[4] Sponsors largely opted to hold assets rather than sell into a lower-multiple environment, resulting in lower LP distributions and growth in NAV. Fueled by depressed deal activity

Exhibit 6

Private markets AUM totaled $13.1 trillion.

Private market assets under management, H1 2023, $ billion

100% = $13.1 trillion



Note: Figures may not sum precisely because of rounding.
[1]Includes turnaround, private investment in public equity, balanced, hybrid funds, and funds with unspecified strategy.
Source: Preqin

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[4] Due to a lag in reported data, market dynamics in the second half of 2023 are not reflected in reported AUM figures.

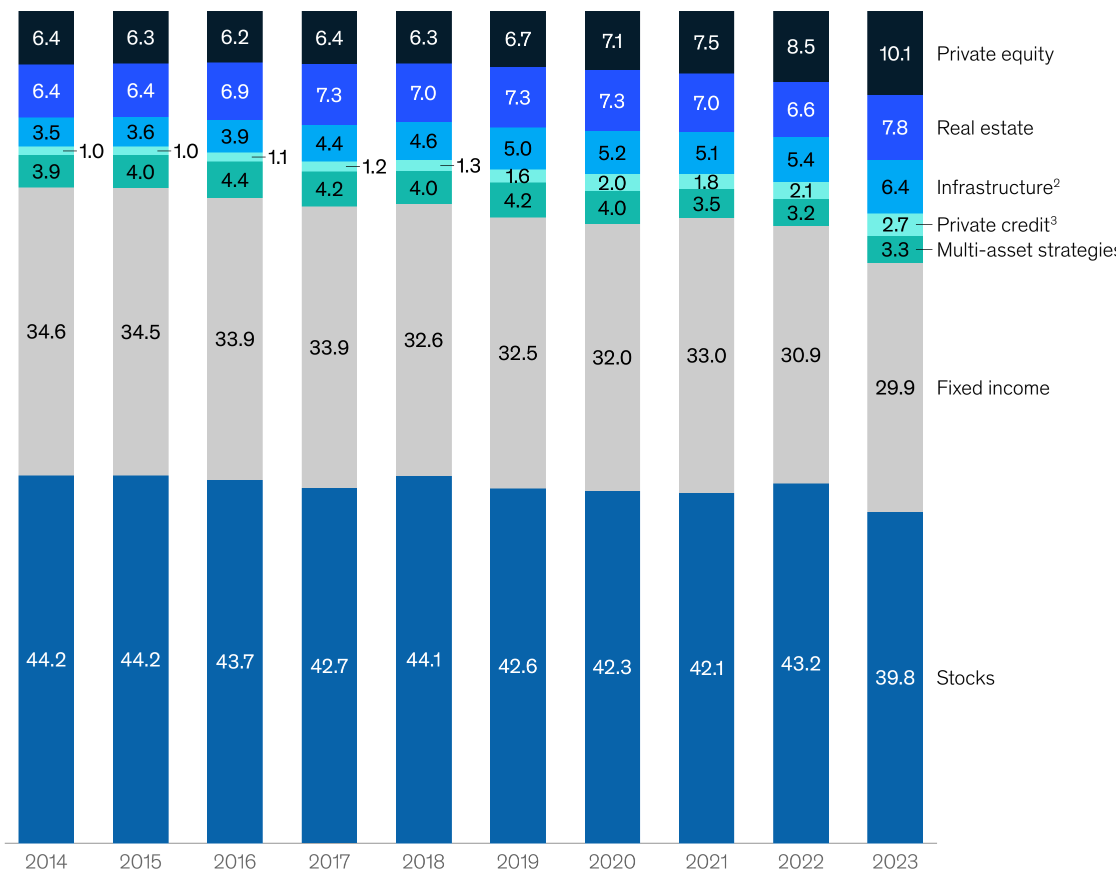
and lower (though still robust) fundraising totals, dry powder grew to a new high of $3.7 trillion, 19 percent above the prior year.

Private markets AUM has grown nearly 14 percent per year since 2013 as institutional investors steadily increase allocations to private asset classes. Institutional investors typically allocate to private markets in search of higher absolute returns, which are required for some to meet their mid- and long-term funding obligations, and to diversify their portfolios. According to CEM Benchmarking, private markets represented 27 percent of institutional portfolios at the beginning of 2023, ten percentage points above their level ten years prior (Exhibit 7).

Exhibit 7

Institutional investors have steadily increased their allocations to private markets.

Institutional investor asset allocations,[1] 2014–23, %



Note: Figures may not sum precisely because of rounding.
[1]Data as of the beginning of each year.
[2]Includes other real assets.
[3]Includes mortgages.
Source: CEM Benchmarking

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Performance

Performance was subdued across private markets asset classes. After losing money in 2022 for the first time since the global financial crisis, PE produced a net IRR of 2.5 percent through September 30, 2023. Despite a marked uptick in performance over the prior year, cumulative returns over the last seven quarters remain negative. Within PE, buyouts returned 4.9 percent during the first nine months of the year, while venture capital (VC) returned –2.9 percent. As of September, buyouts had outperformed VC for seven consecutive quarters, a marked reversal from the recent past: VC had outperformed buyouts in seven of the ten years prior to 2022.

Closed-end real estate funds also lost money in 2023, producing a net IRR of –3.5 percent amid slowing rent growth and cap rate expansion. The performance decline occurred across sectors, including in multifamily and industrial. These two sectors had outperformed in the prior year, which helped offset the broader decline resulting from poor performance of the office sector.

Private debt produced a net IRR of 5.1 percent (6.9 percent annualized) through September 30, 2023, the highest among private markets asset classes. Private debt benefited from higher interest rates and relative insulation from valuation volatility (due to its position in the capital structure), true to its reputation as a safe haven in uncertain times.

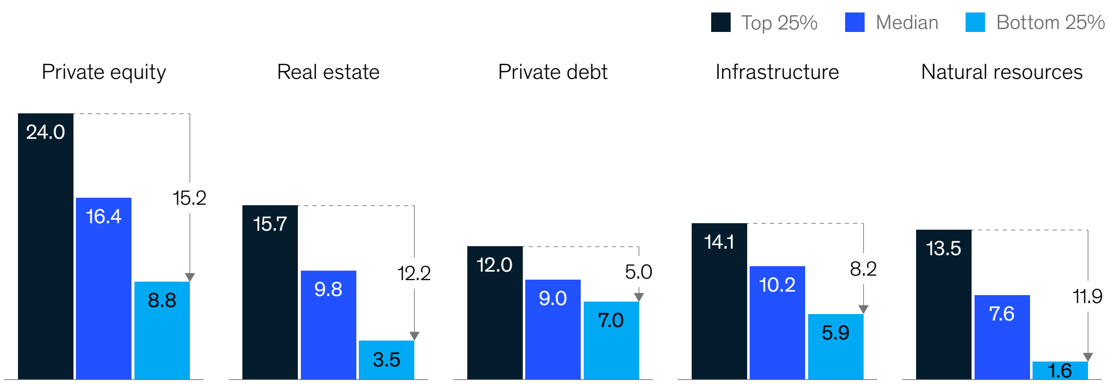
Infrastructure and natural resources returned 3.4 percent and 1.7 percent, well below historical median returns of 10.2 and 7.6 percent, respectively. Factors associated with the lower performance were increased interest rates, lower energy prices, and other macroeconomic headwinds.

PE remains the best-performing private markets asset class over the long run. The median net IRR for PE funds raised between 2011 and 2020 was 16.4 percent as of September 30, 2023, which exceeds the top-quartile return of all other private asset classes. At the same time, the spread between top- and bottom-quartile PE funds of the above vintages was 15 percentage points, 300 basis points in spread more than any other asset class (Exhibit 8).

Exhibit 8

The performance gap between top- and bottom-quartile PE funds is wider than for other asset classes.

Performance by asset class, median IRR and quartile spreads for 2011–20 vintage funds,[1] %



[1]IRR spreads calculated for separate vintage years for 2011–20 and then averaged out. Median IRR was calculated by taking the average of the median IRR for funds within each vintage year. Net IRR to date through Sept 30, 2023.
Source: MSCI Private Capital Solutions

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Such dispersion of fund performance within PE implies that optimal strategy and fund selection matters greatly for returns that LPs achieve in allocating to the asset class. Indeed, performance relative to the median is often the key measuring stick for teams managing private asset portfolios.

Spotlight on secondaries

Fundraising for secondaries strategies totaled $76 billion, up 92 percent year over year, making 2023 the second-highest year on record (Exhibit 9). Though the secondaries market has deepened in recent years, relative concentration among a small number of scaled players often results in annual fundraising volatility. In 2023, for instance, just three funds accounted for $47 billion of funds raised, surpassing the entire strategy's fundraising haul in each of 2021 and 2022.

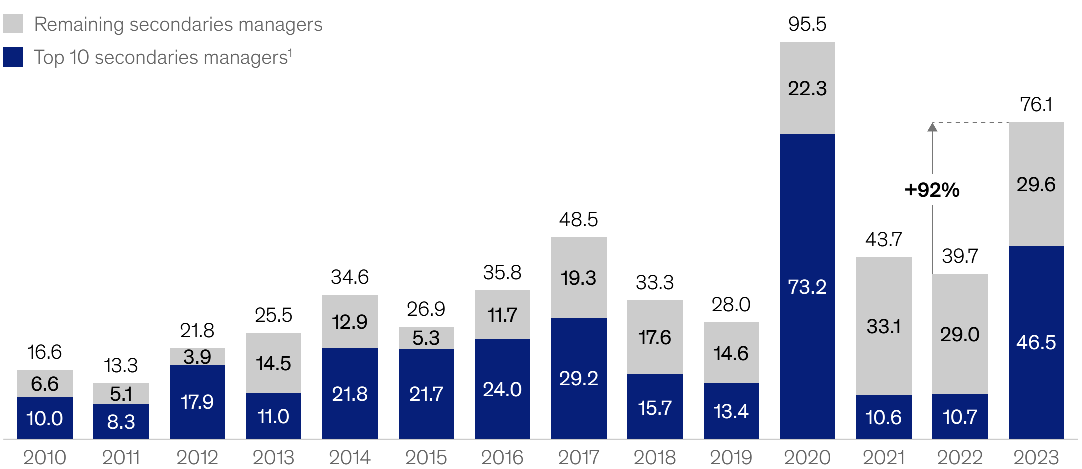
Secondaries funds have now raised more than $255 billion in aggregate over the last four years, nearly twice the total raised in the preceding four-year period. Backed by several years of robust fundraising, secondaries funds play an increasingly important role for LPs and GPs. Global secondaries deal volume grew 4 percent to $112 billion, making 2023 the second most active year on record.[5] And GP-led deals, including continuation vehicles, totaled $52 billion, the third year in a row where volume exceeded $50 billion. GPs now commonly employ continuation vehicles to provide exit opportunities for LPs while extending hold periods for higher-performing assets.

LP-led deals totaled $60 billion, up 7 percent year over year. Given that PE allocations have exceeded targets for many LPs in today's environment, secondary sales offer a mechanism to rebalance

Exhibit 9

Fundraising by the largest secondaries managers increased in 2023.

Global secondaries fundraising, $ billion



Note: Figures may not sum precisely because of rounding.
[1]Top managers are defined by highest aggregate fundraising in secondaries since 2010.
Source: Preqin

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[5] *Global secondary market review*, Jefferies, January 2024.

a portfolio, enabling LPs to make fresh commitments into new fund vintages. Among LPs that sold positions in 2023, 36 percent did so principally to generate liquidity, versus just 14 percent a year ago. Still, LP-led deal volume was slightly lower last year than at its peak in 2021, suggesting that, despite the benefits of using secondaries as portfolio management tools, LPs have not moved en masse to exit positions, in part because of the discount required to do so.

Secondaries pricing stabilized in 2023 after a considerable drop in 2022. In buyouts, pricing improved from 87 percent of NAV to 91 percent, suggesting that the market is beginning to agree with asset marks, though the 2023 level remains below the seven-year average. VC and real estate pricing, conversely, remained steeply discounted, trading at 68 percent and 71 percent of NAV, respectively, signaling continued investor skepticism of current marks in these asset classes.

Spotlight on non-institutional capital

The entrance of non-institutional capital, such as high net worth and retail, into the private markets landscape is one of the most significant structural shifts in recent years. While the majority of private markets AUM continues to be sourced from institutional investors, non-institutional channels are growing at a slightly faster pace. Penetration of private market investments within non-institutional portfolios remains low, but the addressable capital pool for private markets GPs is massive. Non-institutional assets total approximately $53 trillion globally, twice as much as is controlled by global defined benefit pensions, endowments, and sovereign wealth funds combined.[6] However, while institutional investors allocate 27 percent of their assets to private markets on average,[7] non-institutional investors currently allocate just 6 percent.

Retail's growing relevance in the private markets is propelled by both demand and supply factors. With private markets asset classes outperforming their public market equivalents over the past decade, individual investors and their financial advisors are seeking incremental private markets exposure to improve absolute returns and increase diversification.

Regulatory changes are also stimulating demand. In Europe, amendments to the European Long Term Investment Funds in 2023 made private asset classes more accessible to individual investors by easing minimum investment and diversification requirements. And in the United States, the Securities and Exchange Commission's 2023 rulings mandating additional disclosures from GPs for all investor types has lowered the effective barrier to raising retail capital.

Meanwhile, on the supply side, GPs, particularly large, multi-strategy managers, are actively targeting non-institutional capital to sustain their growth trajectories amid a fundraising slowdown from institutional investors. Moreover, the proliferation of investment products has substantially improved asset managers' ability to raise retail capital. Products such as interval funds, tender offer funds, and a new generation of non-traded real estate investment trusts (REITs) and business development companies (BDCs) allow for more frequent subscription and redemption periods to meet retail investors' liquidity needs.

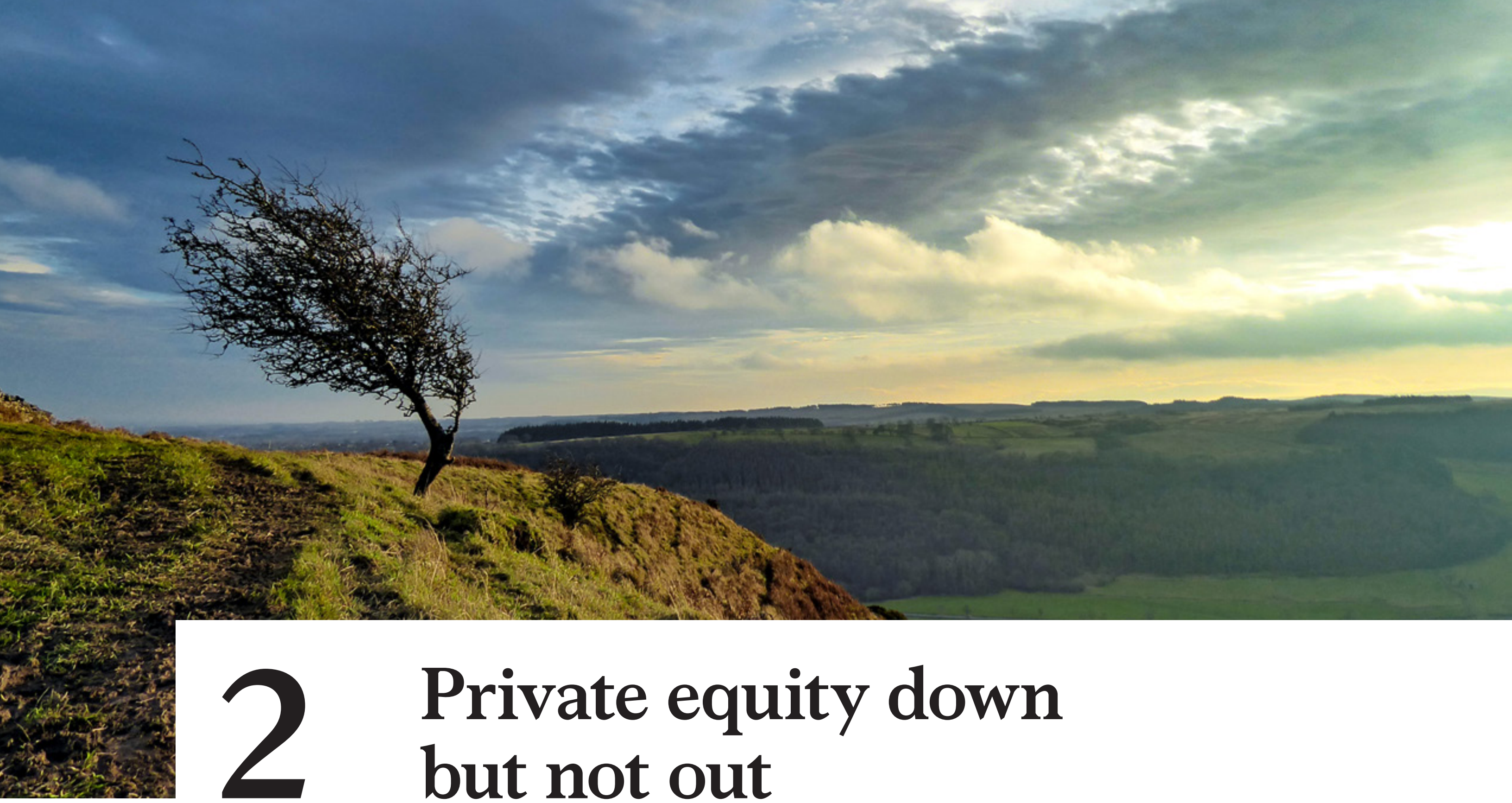
Of course, managing retail capital comes with its share of challenges. Intermittent-liquidity vehicles, for instance, require a separate and complex set of operational capabilities. An ecosystem of new technology solutions, including third-party digital wealth distribution platforms, is helping ease issues related to investor onboarding, subscriptions and redemptions, capital call tracking and collection, and reporting.

[6] McKinsey's Performance Lens Global Growth Cube.
[7] CEM Benchmarking.

Other challenges are yet to be resolved. For example, fundraising from retail channels requires GPs to develop a revamped go-to-market approach, as non-institutional sales are almost entirely conducted through a B2B2C process involving a broad range of intermediaries. A one-size-fits-all sales approach is rarely effective. In addition, effective retail product distribution requires a proactive sales force to actively engage with—and educate—advisers. In addition to maintaining retail products and a distribution platform, GPs hoping to grow substantially in the space must also hire and train a salesforce that has deep relationships and experience in the retail channel.

These factors have contributed to substantially greater concentration of fund flows in the retail channel than in the institutional channel. The largest and best-known managers have captured up to 50 percent of total fundraising in some strategies as a result of their investment in sales teams and brand marketing.[8] Indeed, our research shows that the overall sales and service experience ranks high in the selection of alternative products, second only to investment performance.

[8] Cerulli; GP annual reports.



2 Private equity down but not out

Higher financing costs, lower multiples, and an uncertain macroeconomic environment created a challenging backdrop for private equity managers in 2023. Fundraising declined for the second year in a row, falling 15 percent to $649 billion, as LPs grappled with the denominator effect and a slowdown in distributions. Managers were on the fundraising trail longer to raise this capital: funds that closed in 2023 were open for a record-high average of 20.1 months, notably longer than 18.7 months in 2022 and 14.1 months in 2018. VC and growth equity strategies led the decline, dropping to their lowest level of cumulative capital raised since 2015. Fundraising in Asia fell for the fourth year of the last five, with the greatest decline in China.

Despite the difficult fundraising context, a subset of strategies and managers prevailed. Buyout managers collectively had their best fundraising year on record, raising more than $400 billion. Fundraising in Europe surged by more than 50 percent, resulting in the region's biggest haul ever. The largest managers raised an outsized share of the total for a second consecutive year, making 2023 the most concentrated fundraising year of the last decade.

Despite the drop in aggregate fundraising, PE assets under management increased 8 percent to $8.2 trillion. Only a small part of this growth was performance driven: PE funds produced a net IRR of just 2.5 percent through September 30, 2023. Buyouts and growth equity generated positive returns, while VC lost money. PE performance, dating back to the beginning of 2022, remains negative, highlighting the difficulty of generating attractive investment returns in a higher interest rate and lower multiple environment. As PE managers devise value creation strategies to improve performance, their focus includes ensuring operating efficiency and profitability of their portfolio companies.

Deal activity volume and count fell sharply, by 21 percent and 24 percent, respectively, which continued the slower pace set in the second half of 2022. Sponsors largely opted to hold assets longer rather than lock in underwhelming returns. While higher financing costs and valuation mismatches weighed on overall deal activity, certain types of M&A gained share. Add-on deals, for example, accounted for a record 46 percent of total buyout deal volume last year.

Fundraising

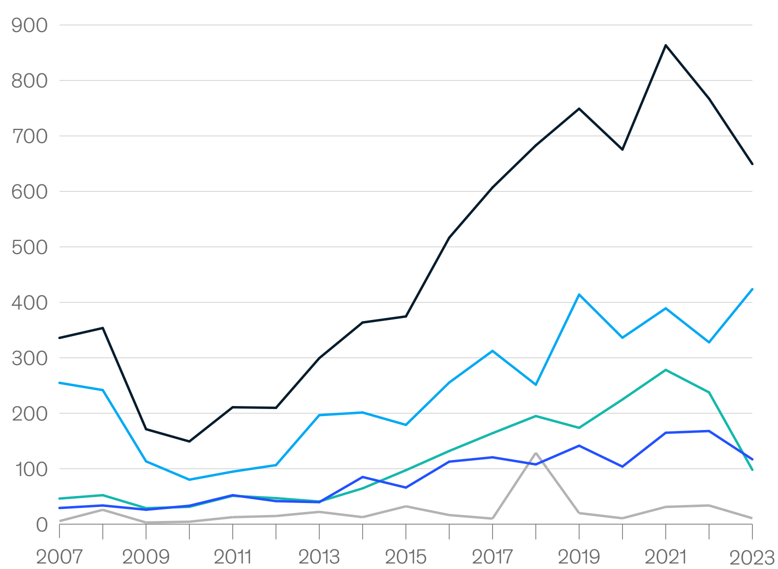
Globally, PE fundraising declined 15 percent to $649 billion in 2023, the lowest total since 2017. The asset class's fundraising challenges mirror those affecting the broader private markets landscape in many respects. Consider the denominator effect, which more than 50 percent of LPs in a recent survey identified as having influenced their capital allocation decisions in 2023.[9] Entering the year, LPs were overallocated to PE by 100 basis points on average, according to CEM Benchmarking. While public equity markets bounced back over the course of the year, exit volume fell 10 percent year over year, which helped drive up NAV (the numerator) and thereby mitigated potential relief from a rebounding denominator.

Fundraising trajectories of the three main PE strategies diverged in 2023. Buyout managers collectively were more successful than they have ever been, raising $424 billion. Conversely, fundraising declined precipitously for both growth equity and VC, with the former declining 30 percent to $117 billion and the latter falling 59 percent to $98 billion, the lowest level since 2016 (Exhibit 10). This marked a reversal of fortune for VC: fundraising for the strategy had grown seven percentage points per year faster than buyout fundraising in the decade leading up to 2022. VC fundraising was also disproportionately impacted by the steep decline of Asia-focused PE fundraising—52 percent of the strategy's fundraising from 2012–2021 came from the region versus just 12 percent for buyout.

Exhibit 10

Global PE fundraising fell to $649 billion.

Global private equity fundraising by sub-asset class,[1] $ billion



	2018–23 CAGR, %	2022–23 growth, %
Total	–1.0	–15.4
Buyout	11.0	29.2
Growth	1.6	–30.4
Venture capital	–12.8	–58.7
Other private equity[2]	–39.2	–68.3

[1]Excludes secondaries, funds of funds, and co-investment vehicles.
[2]Includes turnaround, PIPE, balanced, hybrid funds, and funds with unspecified strategy.
Source: Preqin

McKinsey & Company

[9] Preqin.

North America–focused PE fundraising declined 16 percent year over year to $424 billion, the third-highest annual total on record. Consistent with the global trend, buyout fundraising in North America increased 26 percent to $281 billion, while growth equity fundraising declined 19 percent to $86 billion, and VC fundraising fell 67 percent to $49 billion. Last year was the first year in which growth equity funds raised more capital than VC funds in the region.

Europe-focused PE funds had a record year in many respects. PE fundraising increased 57 percent to $159 billion, propelling Europe ahead of Asia in aggregate capital raising for the first time since 2013. Buyout fundraising increased 87 percent to $122 billion, reversing a three-year negative trend. Europe is also now home to the largest buyout fund on record, which closed at $29 billion last year. Growth equity in the region surged 55 percent to reach $19.1 billion, surpassing VC, for which fundraising declined 25 percent to $17.3 billion.

In Asia, PE fundraising declined 51 percent to $54 billion, the lowest since 2010. Fundraising in the region has declined 77 percent since its peak in 2018. The drop in China-focused fundraising played a significant role in the decline, with only $22 billion raised in aggregate last year, compared to $205 billion in 2017. China's share of PE fundraising in Asia has fallen from 86 percent in 2017 to 41 percent in 2023. Asia-focused VC fundraising decreased 55 percent to $25 billion, growth equity fell 48 percent to $10 billion, and buyout declined 46 percent to $18 billion.

Meanwhile, fundraising in the rest of the world plummeted from $49 billion to $12 billion, following three consecutive years of growth.

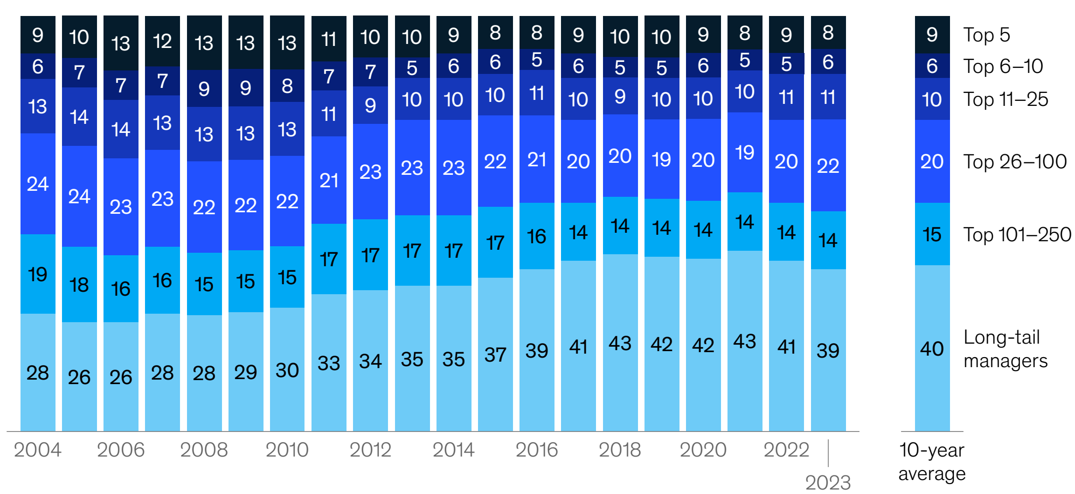
Concentration into larger funds

Over the long term, the market structure in PE has remained remarkably consistent. For example, the share of dollars accruing to the 25 most successful fundraising managers over a given five-year period in the last decade has remained stable between 24 and 25 percent. (Exhibit 11).

Exhibit 11

Relative market concentration has remained remarkably steady in private equity.

Share of trailing 5-year PE fundraising,[1] %



Note: Figures may not sum precisely because of rounding.
[1]Excludes secondaries, funds of funds, and co-investment vehicles.
Source: Preqin

McKinsey & Company

Fundraising in 2023 was more concentrated than in any year of the prior decade, with 47 percent of all dollars raised accruing to just 25 managers (Exhibit 12). On an annual basis, fundraising concentration is heavily influenced by which funds are in the market in a given year, as well as LPs' willingness and ability to back smaller and newer managers. In 2023, as was the case in the year prior, investors concentrated their allocations amid a broader pullback in commitments, allocations to existing managers persisted, and larger funds and their sponsors collected a greater share of capital. Consequently, new firm formation slowed. First-time funds raised $41 billion in 2023, the lowest total since 2013, as launching a new firm proved exceedingly challenging. Whether recent concentration is indicative of oft-rumored consolidation (a hypothesis strengthened by a recent spate of M&A) or is simply a cyclical capital rotation similar to past downturns remains to be determined.

Consistent with the above concentration trend, managers raised (many) fewer but (much) larger funds. Dollars allocated to funds exceeding $5 billion grew 8 percent year over year, while fundraising for vehicles of less than $1 billion fell more than 33 percent.

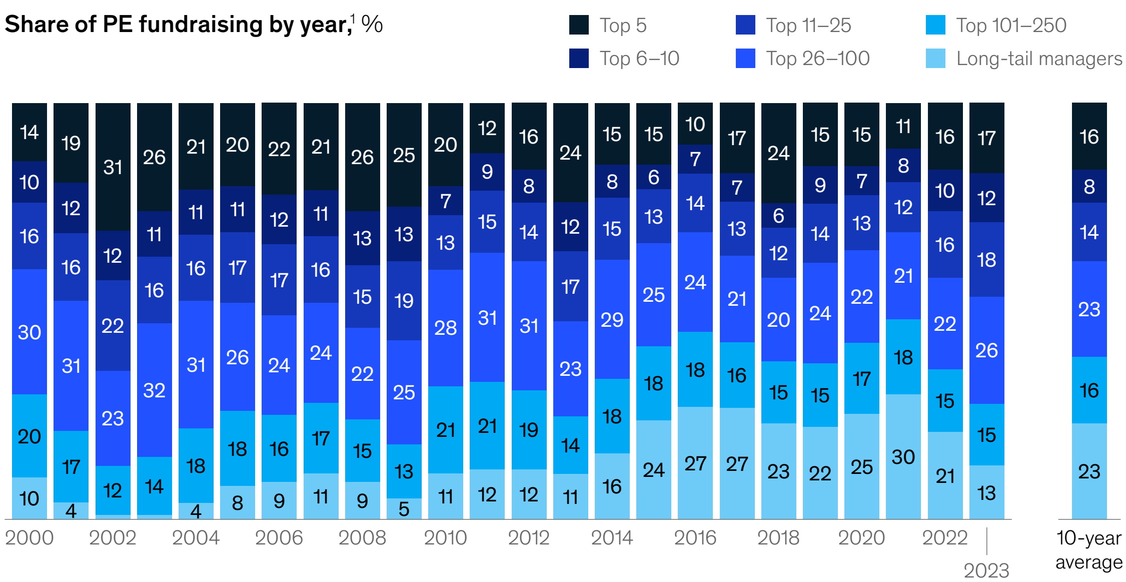
The count of funds smaller than $250 million fell 55 percent to 938, the fewest since 2013 and 70 percent below 2021's peak (Exhibit 13). Meanwhile, ten funds of at least $10 billion closed in 2023, the second most on record. As a result, the average fund size across PE strategies increased to approximately $497 million, up 67 percent year over year and roughly twice the average fund size in 2018.

Increased concentration among larger funds may in part reflect investors' desire to limit risk in an uncertain market. Although the median performance of larger funds is generally comparable to that of smaller funds, the dispersion of returns among larger funds is relatively limited (Exhibit 14).

Exhibit 12

Top managers captured a greater share of PE fundraising in 2023.

Share of PE fundraising by year,[1] %



Note: Figures may not sum precisely because of rounding.
[1]As defined by managers with highest cumulative fundraising in each year. Excludes secondaries, funds of funds, and co-investment vehicles.
Source: Preqin

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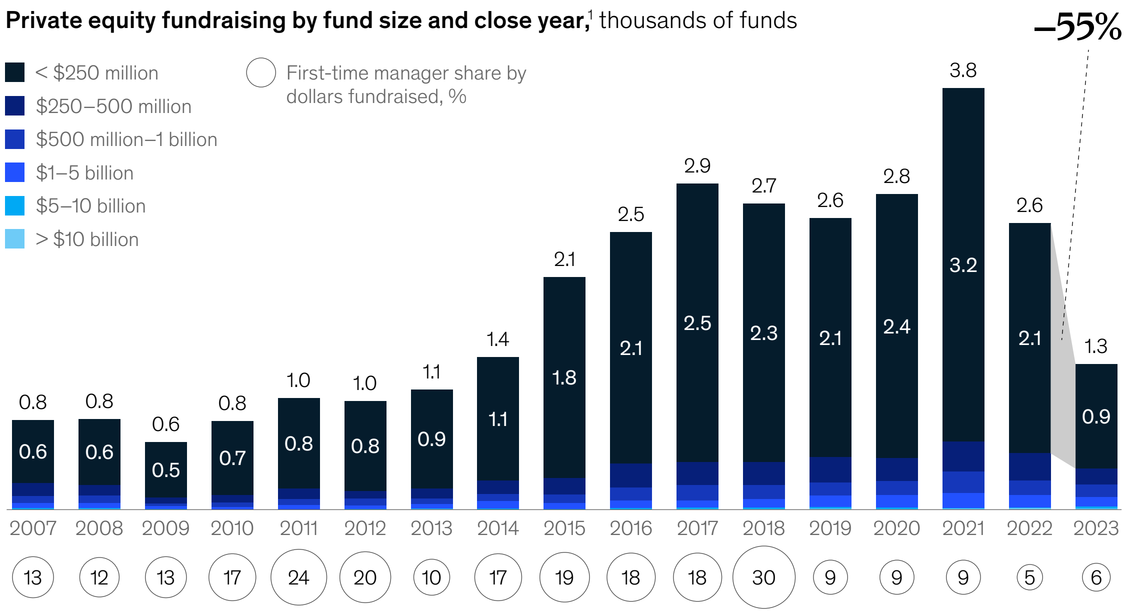
Exhibit 13

The number of small PE funds closed in 2023 fell 55 percent.

Private equity fundraising by fund size and close year,[1] thousands of funds



[1]Excludes secondaries, funds of funds, and co-investment vehicles.
Source: Preqin

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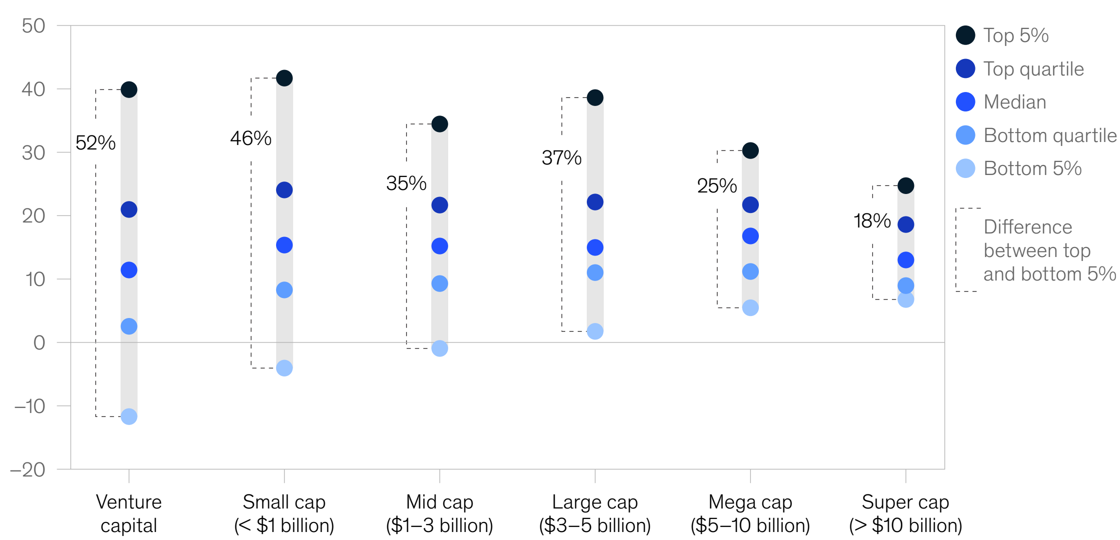
Exhibit 14

Larger buyout funds have smaller performance spreads between top- and bottom-performing funds.

Global buyout fund performance,[1] IRR for 2000–20 vintage funds, %



[1]Fund performance assessed using IRR calculated by grouping performance of 2000–20 vintage buyout funds during 2000–23. Some data not available for certain periods.
Source: MSCI Private Capital Solutions

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AUM

Global private equity AUM increased to $8.2 trillion through June 30, 2023, and has grown 22 percent per year over the last five years. Within PE, the AUM mix has shifted considerably over time. Buyouts accounted for 47 percent of the global total as of the first half of 2023, down from 55 percent in 2018. VC's share was 33 percent during the same period, up from 23 percent five years prior.

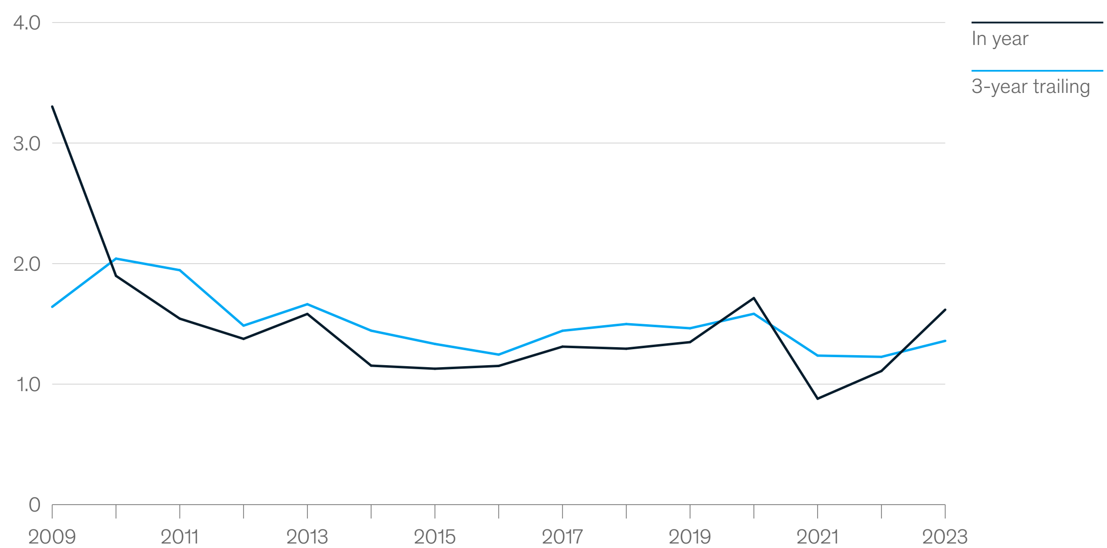
Buyout strategies accounted for a majority share of European and North American AUM (74 percent and 55 percent, respectively). In Asia, however, VC accounted for the majority of AUM, at 58 percent, followed by growth equity's 23 percent and buyouts' 17 percent. The distribution of AUM in the rest of the world was more evenly split, with VC accounting for 38 percent, growth equity 30 percent, and buyouts 31 percent as of June 30, 2023.

PE dry powder grew to a record $2.2 trillion through the first half of 2023, driven by a dramatic slowdown in dealmaking while fundraising continued, albeit at a slower pace. Dry-powder inventory (the amount of capital available to GPs expressed as a multiple of annual deployment) increased from 1.1 years in 2022 to 1.6 years in 2023 but remains within the metric's normal historical range (Exhibit 15).

Exhibit 15

Global inventories of PE dry powder continued to increase in 2023.

Years of private equity inventory on hand,[1] turns



[1]Capital committed but not deployed, divided by equity deal volume. Equity deal volume estimated using transaction volume and leverage figures for the full year. Dry powder for 2023 is based on figure as of June 30, 2023.
Source: PitchBook; Preqin

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Performance

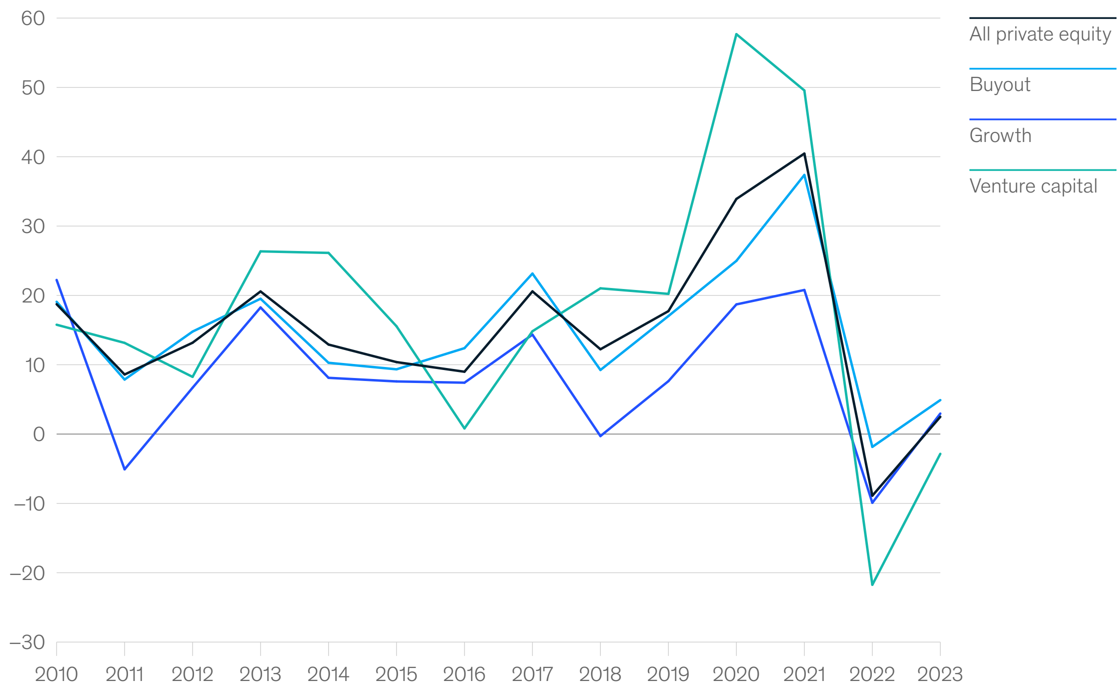
PE rebounded to post modestly positive returns in 2023, achieving a net IRR of 2.5 percent through September. However, despite the improvement, performance in 2023 was still the second worst since the global financial crisis.[10] Buyouts (4.9 percent net IRR) and growth equity funds (3.0 percent) generated positive returns in 2023, while VC lost money (–2.9 percent) for the second consecutive year (Exhibit 16). VC's underperformance in the current environment is not altogether surprising, as the high-growth, long dated cash flows that characterize most VC investments are inherently less valuable in a higher-discount-rate environment.

Despite recent challenges, long-term PE returns remain robust. PE has outperformed other private markets asset classes over the last decade. The median net IRR for PE funds launched between 2011 and 2020 was 16.4 percent as of September 30, 2023, exceeding even the top-quartile returns of all other private asset classes. At the top end,

Exhibit 16

Buyout outperformed other PE strategies.

Performance by strategy, 1-year pooled IRR for 2000–20 vintage funds,[1] %



[1]Fund performance assessed using IRR calculated by grouping performance of 2000–20 funds during 2000–23. Some data not available for certain periods. IRR for 2023 is YTD as of Sept 30, 2023.
Source: MSCI Private Capital Solutions

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[10] As of September 30, 2023.

PE's performance has been exceptional, with top-quartile funds producing net IRRs in excess of 24 percent.

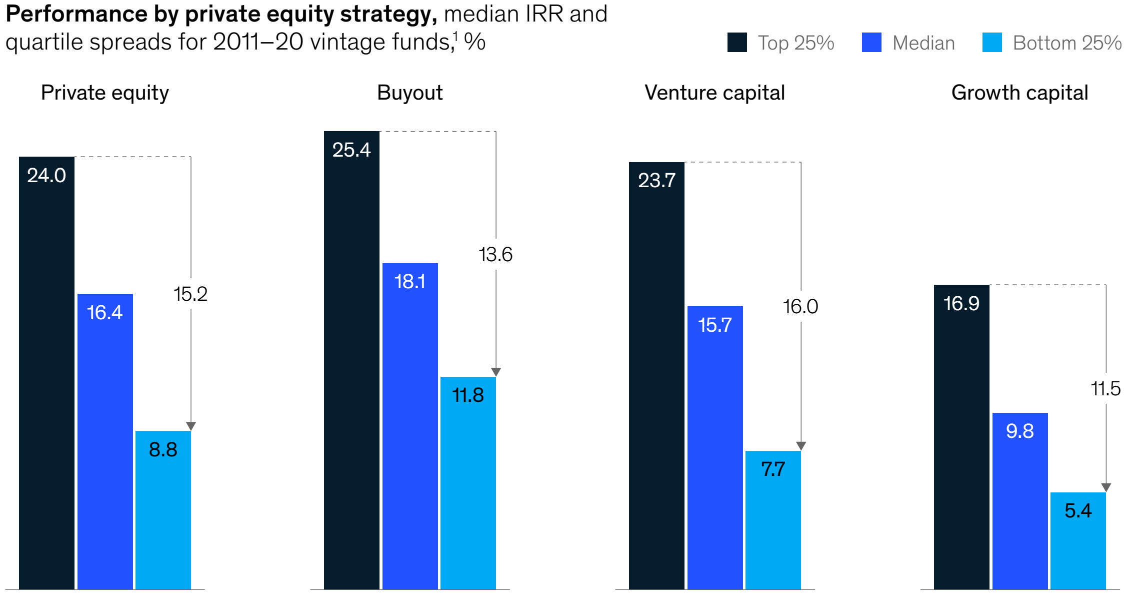
Across strategies, buyout funds have generated the highest returns at every quartile, while VC has the widest variation in fund performance, a 16-percentage-point interquartile spread (Exhibit 17). Growth equity returns have been the least impressive, though dispersion of returns among growth equity funds is relatively low.

Though PE underperformed public equities in 2023 (the MSCI World Index returned 22.6 percent through the third quarter of 2023), it has outperformed public equivalents over longer periods. According to the Kaplan-Schoar Public Market Equivalent analysis, which benchmarks PE performance against a public market index by accounting for the timing of cash flows, the median PE fund from 2010–20 vintages outperformed its public market equivalent by 1.1 times. In fact, the median PE fund in every vintage during the measured decade outperformed public market equivalents.[11]

Exhibit 17

Buyout funds have higher average returns and lower dispersion than venture capital.

Performance by private equity strategy, median IRR and quartile spreads for 2011–20 vintage funds,[1] %



[1]IRR spreads calculated for funds for separate vintage years from 2011–20 and then averaged out. Median IRR was calculated by taking the average of the median IRR for funds within each vintage year; net IRR to date through Sept 30, 2023.
Source: MSCI Private Capital Solutions

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[11] MSCI Private Capital Solutions.

In today's environment, the drivers of investment returns for PE funds are evolving. According to an analysis by the StepStone Group, historical returns have been substantially driven by market multiple expansion and leverage (Exhibit 18). However, decade-long tailwinds of low and decreasing interest rates and expanding multiples have seemingly reversed, perhaps limiting fund managers' ability to rely on these two sources of investment performance. Now alpha generation at the asset level—growing revenue and increasing margin—has become increasingly important for managers seeking to reach or exceed their return targets.

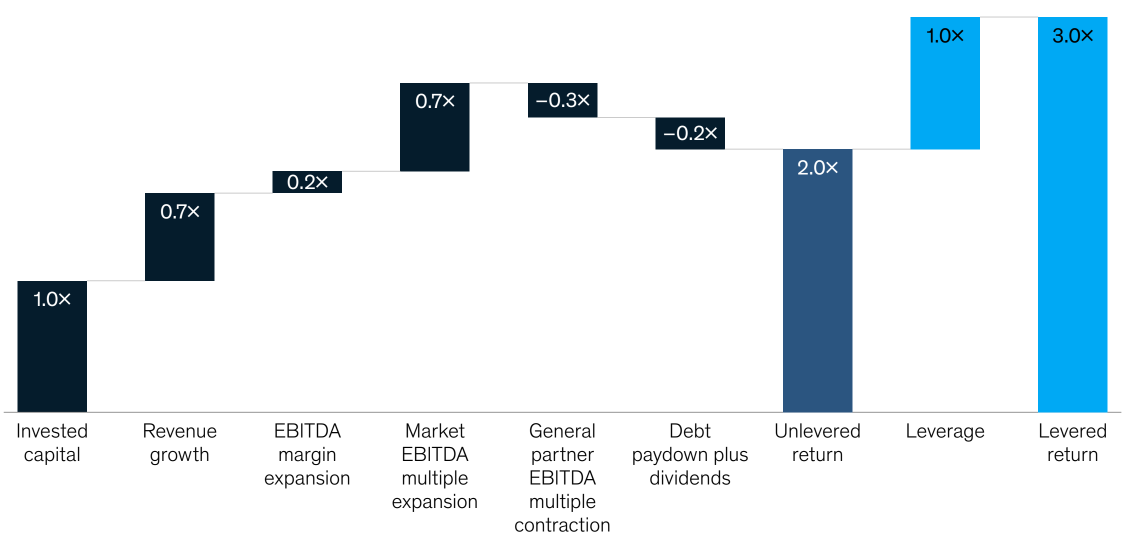
Deal activity

Higher interest rates led to a substantial drop in deal volume for the second consecutive year. After a frenzied 2021, during which volume spiked to an all-time high of $3.4 trillion, and robust activity in the first half of 2022, dealmaking became more difficult in 2022's second half. That slower pace continued through 2023, with deal volume totaling $2.1 trillion, down 21 percent from the prior year and 38 percent below the 2021 peak. Deal count fell more sharply, declining 24 percent to less than 54,000. Even so, 2023 remained the third most active dealmaking

Exhibit 18

Leverage and market multiple expansion drove 67 percent of investment returns for buyout deals from 2010 to 2021.

Drivers of investment returns for realized deals, 2010–21,[1] multiple of invested capital



[1]Sample includes 2,512 buyout deals that were entered on or after Jan 1, 2010, and exited on or before Dec 31, 2021.
Source: SPI by StepStone

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year on record as measured by both volume and deal count (Exhibit 19).

Deal volume decreased 23 percent in North America, to just under $1.1 trillion, and 19 percent in Europe, to $740 billion. The steepest decline was in Asia, where deal volume decreased 26 percent to $200 billion.

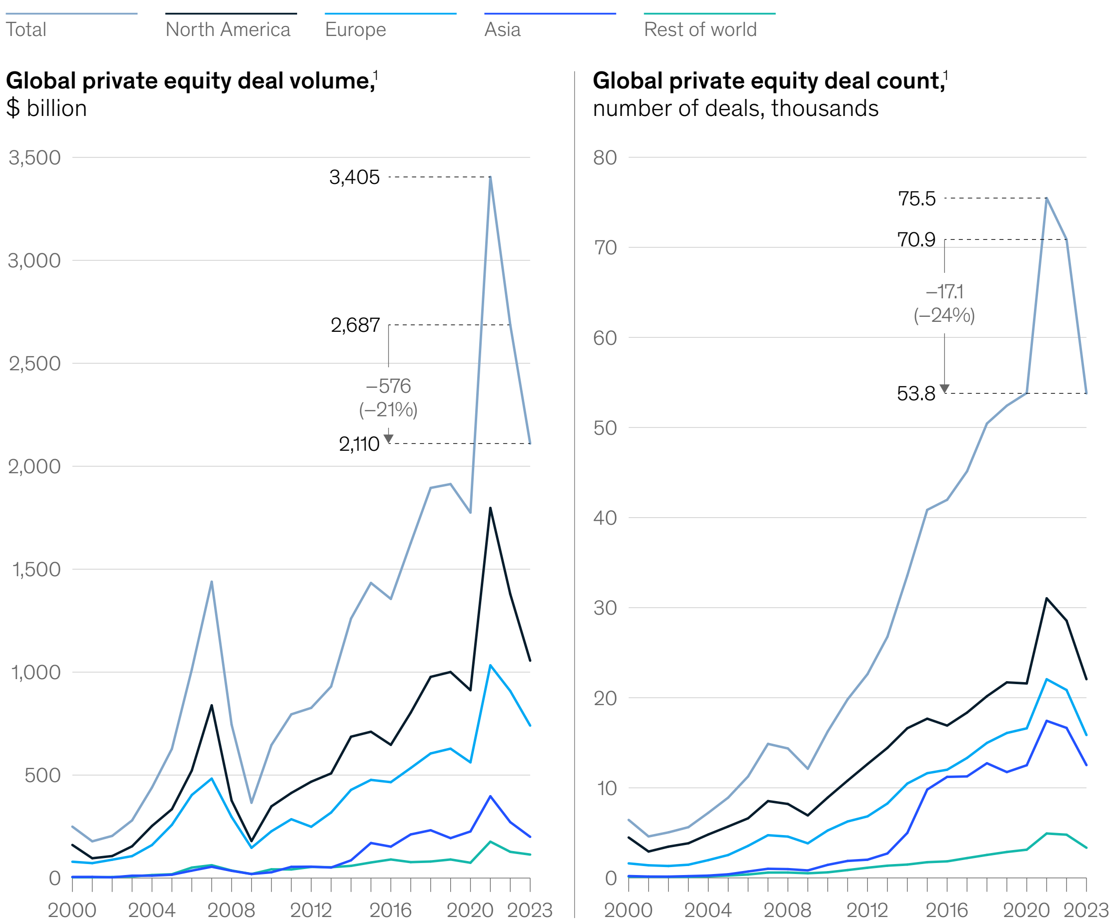
Global buyout deal volume declined 19 percent to $1.5 trillion, while growth equity fell 14 percent to $240 billion. VC deal volume declined the most among PE strategies, dropping 36 percent to $342 billion, as new funding and follow-on raises became harder to achieve.

Deal volumes in the information technology and energy sectors declined the most year over year, decreasing by 38 percent and 31 percent, respectively. Meanwhile, deal volume grew in two sectors: materials and resources and financial services (Exhibit 20).

Non-platform (also known as add-on) deals have consistently grown in popularity as a means for established portfolio platforms to accelerate growth

Exhibit 19

Private equity deal volume declined 21 percent.



[1]Includes buyout/LBO (add-on, asset acquisition, carve-out, corporate divestiture, debt conversion, distressed acquisition, management buyout, management buy-in, privatization, recapitalization, public-to-private, secondary buyout); growth/expansion (recapitalization, dividend recapitalization, and leveraged recapitalization); platform creation; angel; seed round early-stage VC; later-stage VC; restarts (angel, early-stage VC, later-stage VC).
Source: PitchBook

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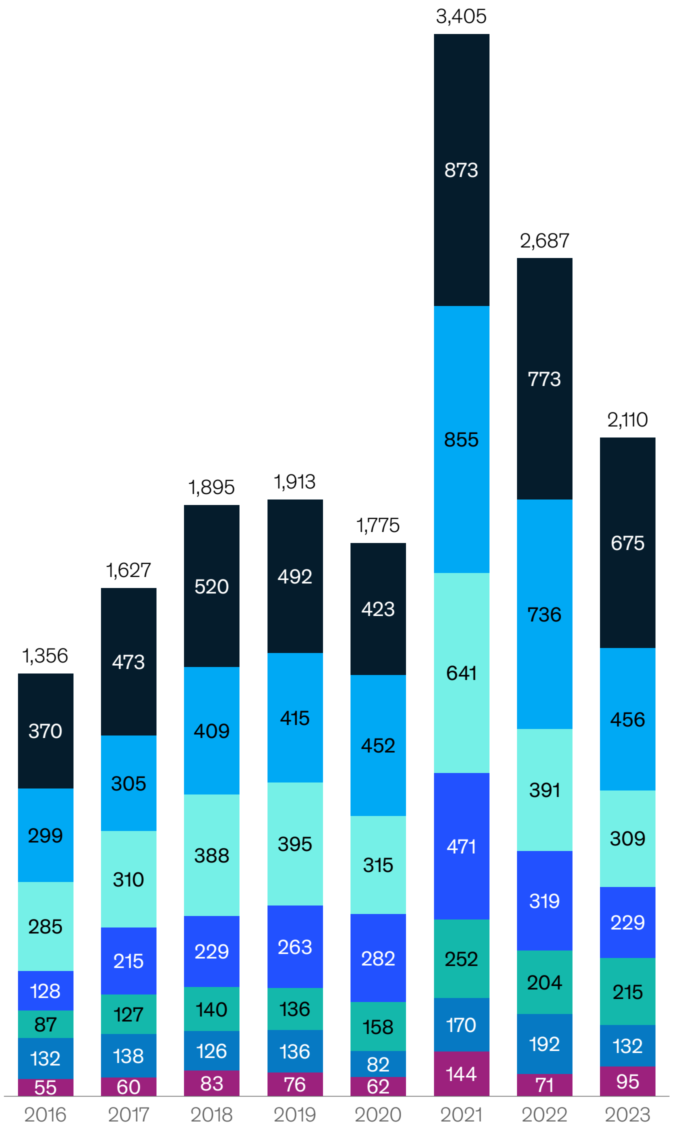
Exhibit 20

Deal activity declined the most in information technology, energy, and healthcare sectors.

Global private equity deal volume by sector, $ billion



	2018–23 CAGR, %	2022–23 CAGR, %
Business products and services (B2B)	5.4	–12.7
Information technology	2.2	–38.1
Consumer products and services (B2C)	–4.5	–21.0
Healthcare	–0.1	–28.4
Financial services	9.0	5.3
Energy	0.9	–31.2
Materials and resources	2.9	33.5

Note: Figures may not sum precisely due to rounding.
Source: PitchBook

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and recognize synergies. Non-platform deals represented 70 percent of the total buyout deal count in 2023, up more than 20 percentage points from 2010 levels (Exhibit 21). As a percentage of buyout deal volume, non-platform deals accounted for 46 percent, the highest ratio in more than a decade. Historically, GPs seek to benefit from the multiple arbitrage available from adding a smaller business (that, on average, trades at a lower multiple) to an existing platform (that trades at a higher multiple) in situations where the acquired companies are properly integrated and synergies have been proven.

Exits

Amid the broader decline in deal volume, PE exit volume fell substantially, as sponsors opted to avoid selling into a lower-multiple environment. Global exits by count declined 23 percent, reaching their lowest level since 2013. Measured by dollar volume, exits declined 10 percent to $840 billion, falling well below the past decade's average annual volume of $1 trillion.

The decrease in exits was particularly noticeable in North America, where PE exits (excluding VC) declined 28 percent by volume from the previous year. In Europe and Asia, exits fell 12 percent and 1 percent, respectively.[12]

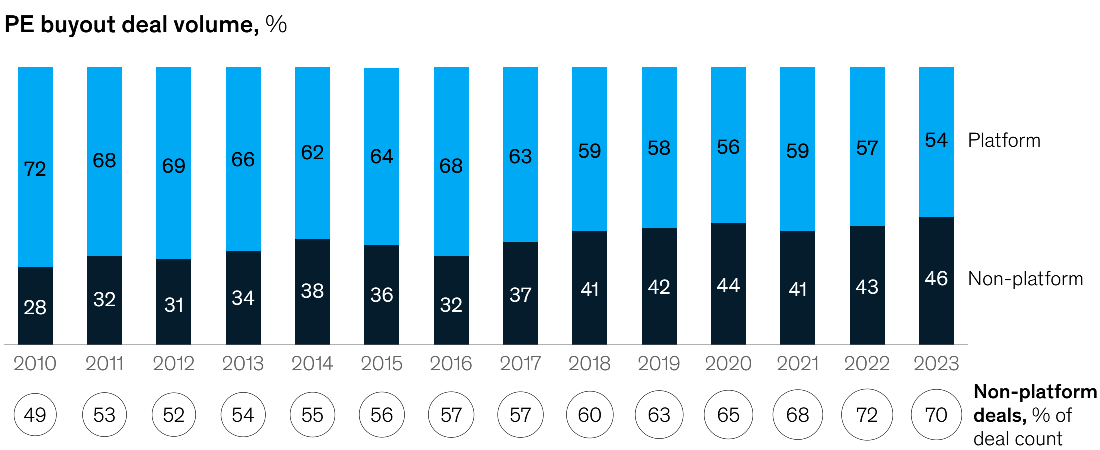
Continued decline in exits has led to an increase in the average holding period for funds. In 2023, average holding periods reached a record high of 6.8 years.[13] Mathematically, funds with a longer hold period require a higher multiple of invested capital (MOIC) to reach similar IRRs, further emphasizing the importance of value creation and earnings growth in the current environment.

Deal multiples and leverage

From 2010 to 2022, PE and public market multiples expanded steadily, with valuation growth in the private markets slightly surpassing that in public markets. The median buyout purchase price multiple increased from 7.7 times to 11.9 times EBITDA over this period.[14] In other words, an investor had to pay roughly 50 percent more in 2022 than 2010 to

Exhibit 21

Non-platform deals accounted for an increased share of PE buyout activity.



Source: PitchBook

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[12] PitchBook.
[13] Ibid.
[14] StepStone Group.

acquire the same EBITDA. Multiple expansion provided a consistent tailwind for investors through this period: of investments made since the Global Financial Crisis, nearly every investment was consummated in a lower-multiple environment than the environment into which it was exited.

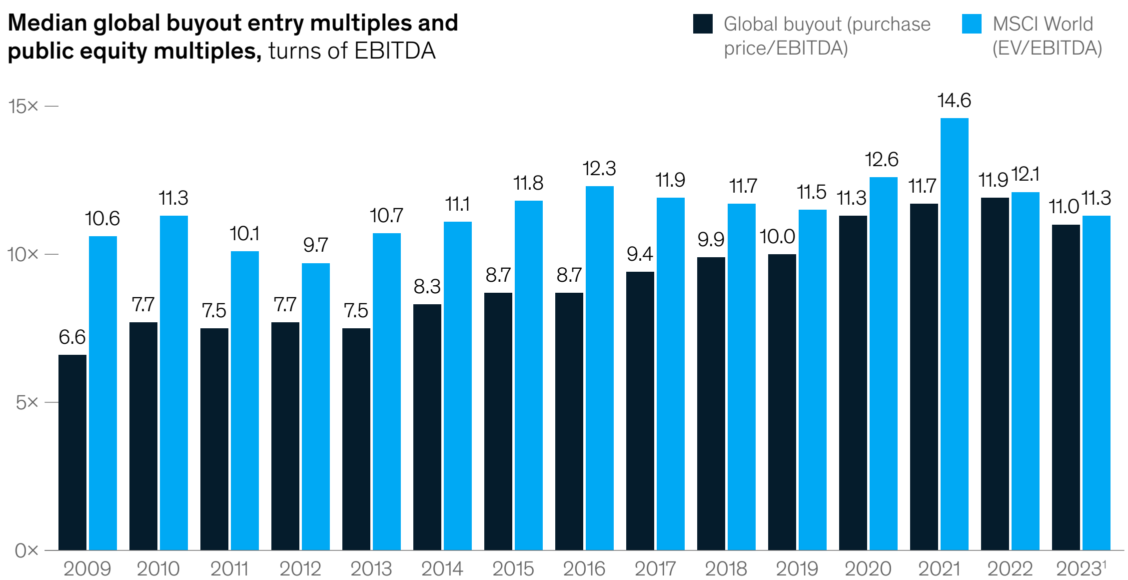
Multiples' upward march reversed in 2023, however, declining for the first time in a decade. Through September 30, 2023, the year-to-date median global buyout multiple fell by nearly one turn to 11 times EBITDA. Global public equity multiples decreased as well, declining to 11.3 times EBITDA through September from an average of 12.1 times in 2022 (Exhibit 22).

The largest year-over-year compressions in purchase price multiples (–1.5 times) occurred in information technology—which had experienced more than eight turns of multiple expansion from 2009 to 2021, the most among any sector—and in industrials. Financial services multiples bucked the trend (+0.2 times, continuing a five-year expansion streak), as did communication services multiples (+1.1 times).

Exhibit 22

Global buyout entry multiples declined nearly one turn.

Median global buyout entry multiples and public equity multiples, turns of EBITDA



[1]Global buyout and MSCI World data as of Sept 29, 2023.
Source: Bloomberg; SPI by StepStone

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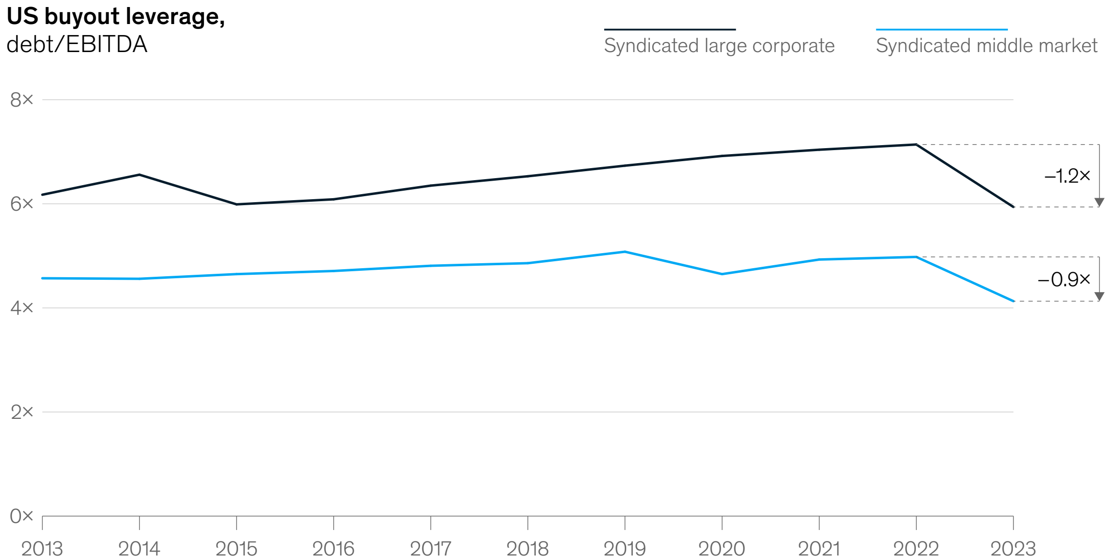
Exhibit 23

US buyout leverage declined approximately one turn in 2023.



Source: LSEG LPC

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US buyout leverage declined by roughly one turn in 2023, falling from 7.1 to 5.9 times EBITDA for large corporate deals, and from 5.0 to 4.1 times for middle-market deals (Exhibit 23). Higher financing costs and lower valuation multiples contributed to a marked decline in the use of leverage from the previous year's record high.

Historical PE performance has been driven significantly by leverage, which accounted for approximately 50 percent of investment returns for buyout deals from 2010 to 2021, according to the StepStone Group. Reduced use of leverage in the current environment, combined with the higher cost of financing, will have a mitigating effect on investment returns for the current vintage of deals, all else equal. This trend, combined with lower exit multiples (should they sustain), will make operational improvements within portfolio companies critical for investment outperformance in the current environment.

3 Real estate recedes

For real estate, 2023 was a year of transition, characterized by a litany of new and familiar challenges. Pandemic-driven demand issues continued, while elevated financing costs, expanding cap rates, and valuation uncertainty weighed on commercial real estate deal volumes, fundraising, and investment performance.

Managers faced one of the toughest fundraising environments in many years. Global closed-end fundraising declined 34 percent to $125 billion. While fundraising challenges were widespread, they were not ubiquitous across strategies. Dollars continued to shift to large, multi-asset class platforms, with the top five managers accounting for 37 percent of aggregate closed-end real estate fundraising. In April, the largest real estate fund ever raised closed on a record $30 billion.

Capital shifted away from core and core-plus strategies as investors sought liquidity through redemptions in open-end vehicles and reduced gross contributions to the lowest level since 2009. Opportunistic strategies benefited from this shift, as investors turned their attention toward capital appreciation over income generation in a market where alternative sources of yield have grown more attractive.

In the United States, for instance, open-end funds, as represented by the National Council of Real Estate Investment Fiduciaries Fund Index – Open End Equity (NFI-OE) Index, recorded $13 billion in net outflows in 2023, reversing the trend of positive net inflows throughout the 2010s. The negative flows mainly reflected $9 billion in core outflows, with core-plus funds accounting for the remaining outflows, which reversed a 20-year run of net inflows.

As a result, the NAV in US open-end funds fell roughly 16 percent year over year. Meanwhile, global assets under management in closed-end funds reached a new peak of $1.7 trillion as of June 2023, growing 14 percent between June 2022 and June 2023.

Real estate underperformed historical averages in 2023, as previously high-performing multifamily and industrial sectors joined office in producing negative returns caused by slowing demand growth and cap rate expansion. Closed-end funds generated a pooled net IRR of –3.5 percent in the first nine months of 2023, losing money for the first time since the global financial crisis. The lone bright spot among major sectors was hospitality, which—thanks to a rush of postpandemic travel—returned 10.3 percent in 2023.[15] As a whole, the average pooled lifetime net IRRs for closed-end real estate funds from 2011–20 vintages remained around historical levels (9.8 percent).

[15] Based on NCREIFs NPI index. Hotels represent 1 percent of total properties in the index.

Global deal volume declined 47 percent in 2023 to reach a ten-year low of $650 billion, driven by widening bid–ask spreads amid valuation uncertainty and higher costs of financing.[16] Deal flow in the office sector remained depressed, partly as a result of continued uncertainty in the demand for space in a hybrid working world.

Closed-end funds

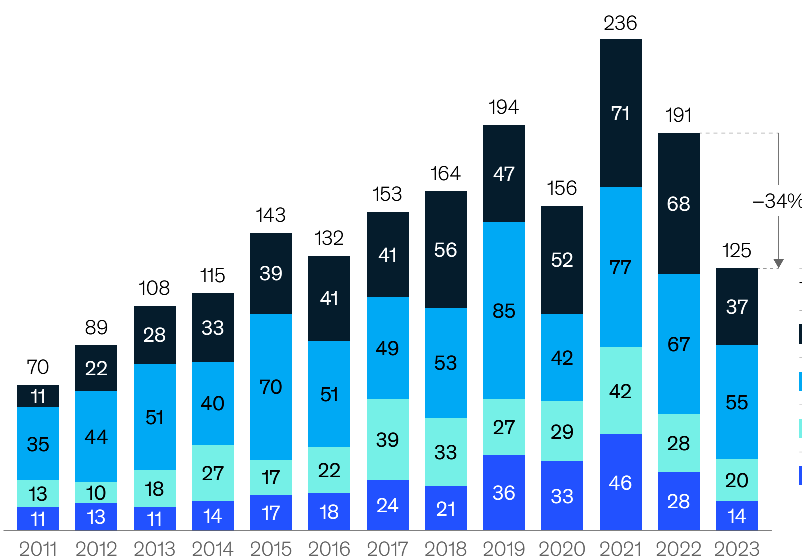
Global closed-end fundraising fell 34 percent year over year to $125 billion, the lowest total raised since 2014. Fundraising volumes declined broadly across regions, albeit at different rates. Fundraising in North America fell 37 percent to $84 billion, marking the second consecutive annual decline off the 2021 peak. Despite the drop, North America continues to be the largest fundraising market. Fundraising in Asia declined 41 percent to $15 billion, while European fundraising fell a more moderate 14 percent to $22 billion.

Fundraising declines were similarly widespread across risk strategies, with some thematic variation (Exhibit 24). Fundraising for closed-end core and core-plus funds, already a small share of the market, dropped 51 percent from the prior year, the largest drop among strategies. Since 2021, fundraising for the lowest-risk equity strategies has declined 70 percent as investors shifted commitments toward strategies more reliant upon capital return. Despite this trend, fundraising for opportunistic vehicles, typically the largest segment in closed-end real estate, fell 18 percent to $55 billion.

Exhibit 24

Closed-end real estate fundraising fell to $125 billion.

Global closed-end real estate fundraising by strategy,[1] $ billion



	2018–23 CAGR, %	2022–23 growth, %
Total	–5.2	–34.3
Value added	–7.7	–44.6
Opportunistic[2]	0.4	–18.4
Debt	–9.7	–30.5
Core and core-plus	–8.5	–51.1

Note: Figures may not sum precisely because of rounding.
[1]Excludes secondaries, funds of funds, and co-investment vehicles.
[2]Includes distressed real estate.
Source: Preqin

McKinsey & Company

[16] CBRE; Real Capital Analytics.

Returns

Global closed-end real estate funds returned −3.5 percent net IRR through the first nine months of 2023, the first time the asset class has generated negative returns since the Global Financial Crisis. The loss in 2023 follows a ten-year high of 26 percent posted in 2021, enabled by rapid rent growth and cap rate compression in certain sectors, and a modest 1.5 percent return in 2022 as those trends slowed or reversed.

Despite recent volatility in a challenging market environment, long-term returns for closed-end real estate funds remain relatively consistent. As of September 30, 2023, every vintage from 2010 to 2020 has produced a pooled-net IRR between 7.5 and 12.5 percent. The median net IRR for funds in that vintage set stands at 9.9 percent, which is in line with infrastructure returns and trails PE by roughly 600 basis points.

AUM

Total global real estate AUM in closed-end funds grew to a record high of roughly $1.7 trillion as of June 2023. The 13 percent year-over-year increase primarily came from capital flowing into higher-risk strategies (for instance, opportunistic), though with some regional variation. Asia was the fastest growing of the major regions, with AUM increasing by roughly 28 percent to $226 billion. In North America, AUM increased 16 percent to $989 billion, while European AUM increased 3 percent to reach $379 billion.

Despite a less productive year in fundraising, dry powder in closed-end real estate funds grew by 19 percent in the first six months of 2023, spurred by a slow deal market, to reach a new all-time high of $548 billion. Over the last five years, dry powder in the asset class has grown by roughly 13 percent per year.

Despite recent volatility in a challenging market environment, long-term returns for closed-end real estate funds remain relatively consistent.

Market concentration

As in other private markets asset classes, fundraising became increasingly concentrated in 2023 as investors continued to favor established names and larger funds. Just five managers raised 37 percent of the aggregate closed-end fundraising in 2023—the highest proportion since 2001 and up 20 percentage points from 2021 (Exhibit 25).

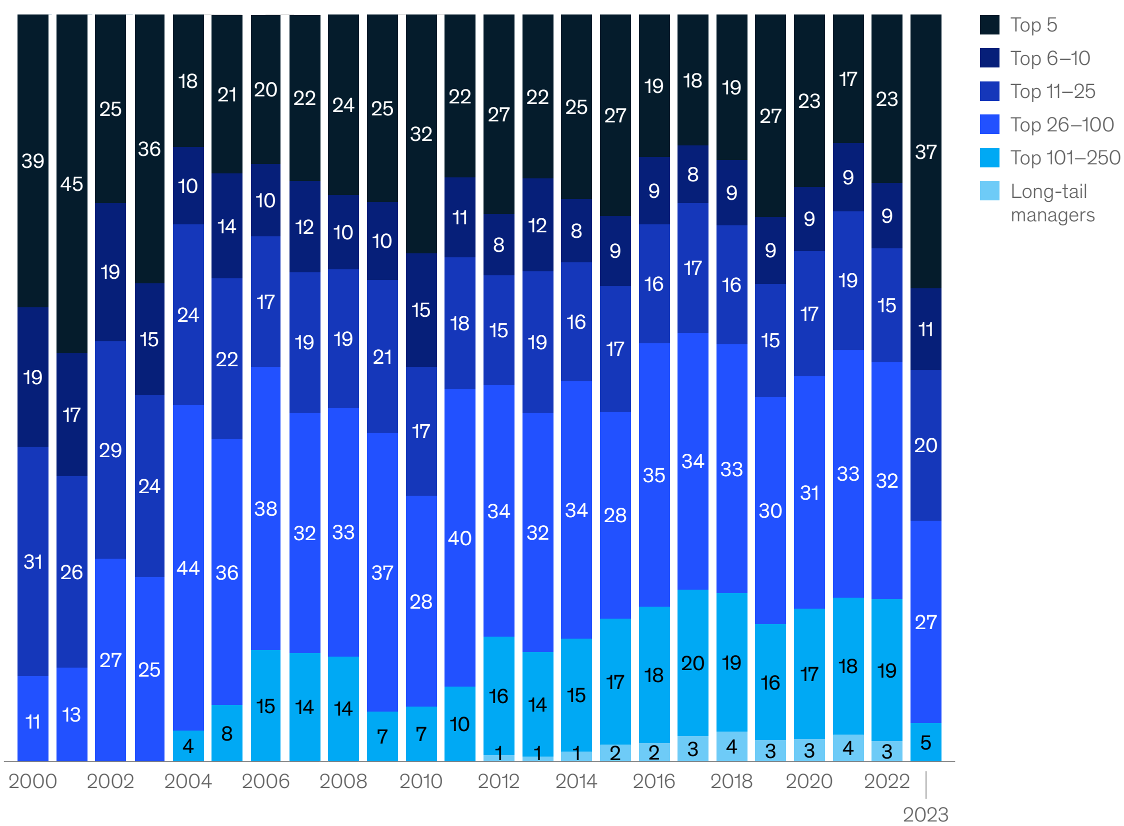
Managers raised fewer and larger funds during 2023. The average size of closed-end real estate funds, for example, increased 17 percent to $418 million. In the markedly difficult environment for new entrants, the number of funds that closed in 2023 totaled 457, notably fewer than 743 in 2022 and the decade's peak of 865 in 2021.

Meanwhile, funds greater than $1 billion accounted for roughly 64 percent of the overall fundraising total, up from 51 percent in 2022. The shift to larger funds in a difficult environment is consistent with prior downturns, such as the Global Financial Crisis and the dot-com crash, and is perhaps a form of risk management for LPs. In real estate, larger funds outperform at the median, and the dispersion of returns among larger funds is relatively narrow

Exhibit 25

Fundraising concentration in the top five closed-end funds reached a 20-year high.

Closed-end real estate fundraising by year, %



Note: Figures may not sum precisely because of rounding.
Source: Preqin

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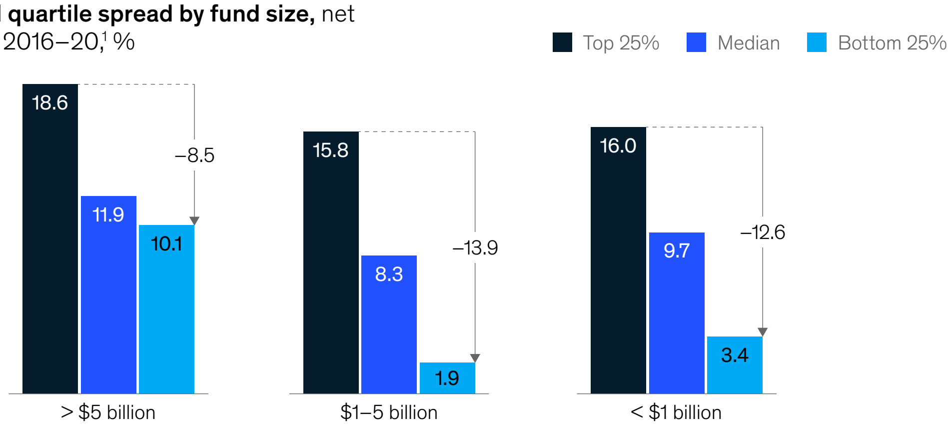
Exhibit 26

Real estate funds larger than $5 billion have outperformed, with less dispersion.

Median IRR and quartile spread by fund size, net IRR for vintages 2016–20,[1] %



[1]Net IRR of funds through Sept 30, 2023. IRR spreads were calculated for funds within vintage years separately and then averaged out. Median IRR was calculated by taking the average of the median IRR for funds within each vintage year.
Source: MSCI Private Capital Solutions

McKinsey & Company

(Exhibit 26). Large managers leverage their scale to attract and retain talent, acquire diverse portfolios, engage in systematic joint ventures with operators (or acquire operating companies in their entirety), and invest in digital capabilities to enhance efficiency and gain valuable insights.

Open-end funds

Within open-end funds in the United States, as represented by the NFI-OE Index, distributions and redemptions exceeded contributions, reversing the 2022 trend. Nearly $13 billion in capital flowed out of US open-end funds in 2023, compared with net inflows approaching $3 billion in 2022 (Exhibit 27). The reduction in net inflows mainly resulted from a 74 percent ($23 billion) reduction in gross contributions, which had reached a record high during the prior year. While dollars have flowed out of core funds for five consecutive years, the change in the overall trend was driven by net outflows from core-plus vehicles that experienced net outflows for the first time in two decades.

Returns

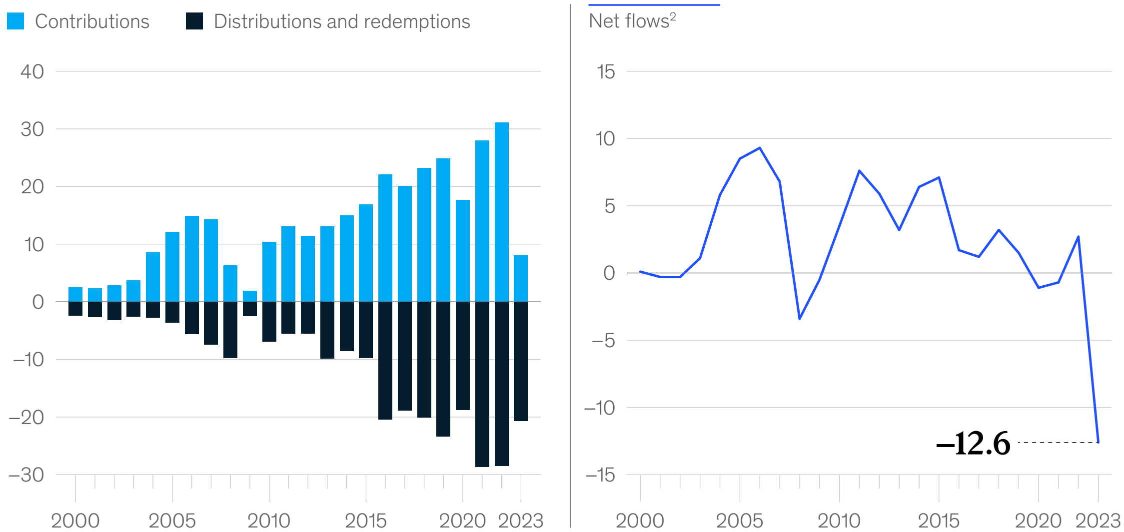
Open-end fund performance declined considerably, and the category fared worse than closed-end funds. NFI-OE funds returned –12.2 percent on a net basis, the first annual decline since the global financial crisis and a marked drop from the strong performance in 2021 and 2022.

Given elevated interest rates and uncertain demand, cap rates expanded approximately 60 basis points to reach 5.1 and 5.7 percent in industrial and multifamily sectors respectively, while the office sector expanded by roughly 300 basis points, reaching almost 11 percent (Exhibit 28). Unlike last year, rent growth did not offset cap rate expansion contributing to lower returns in most sectors.

Exhibit 27

Net outflows for US open-end funds reached $13 billion, the lowest level on record.

Open-end real estate investor cash flows,[1] $ billion



[1]NFI-OE includes real estate open-end vehicles across all strategies.
[2]Contributions less distributions and redemptions.
Source: National Council of Real Estate Investment Fiduciaries

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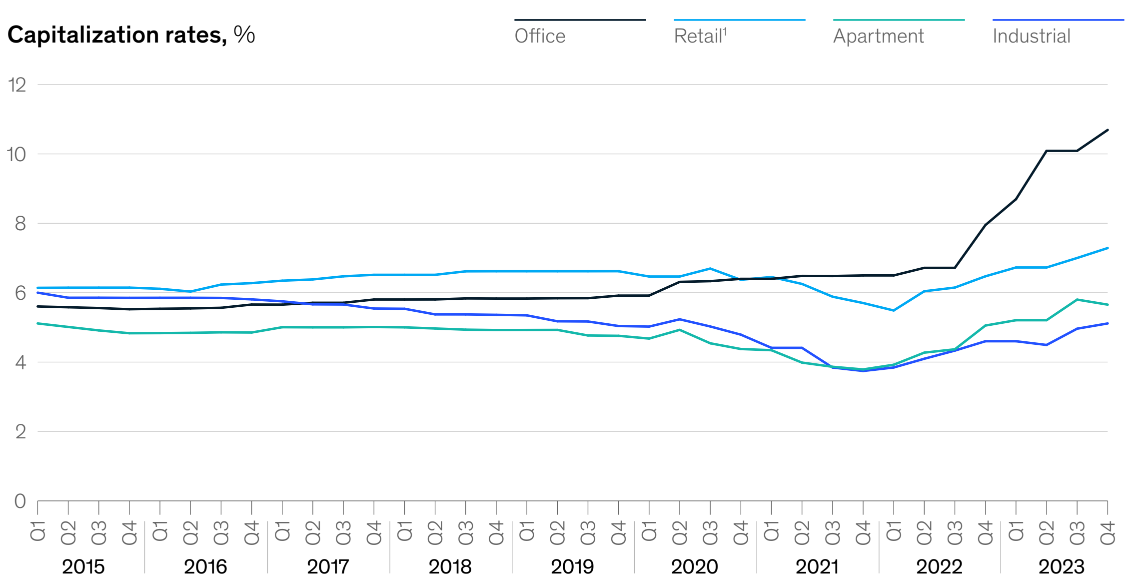
Exhibit 28

Cap rate expansion continued in 2023.

Capitalization rates, %



[1]Defined as strip centers.
Source: Green Street

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Performance varied across sectors. The office sector posted the lowest annual returns (–17.6 percent), while hospitality assets produced the strongest returns (10.3 percent). In stark contrast to their high performance over the last several years, multifamily and industrial sectors posted returns of –7.3 and –4.1 percent, attributable to slowing rent growth[17] and expanding cap rates.

Net asset value

The total NAV of funds included in the NFI-OE Index reached $309 billion, down 16 percent from $368 billion in the fourth quarter of 2022 and the sharpest decline since 2010, when NAV fell 20 percent. Still, over the long term, growth in NAV has been substantial, increasing 17 percent per year between 2010 and 2022.

Deal activity

Global real estate deal activity declined in 2023, as it did in the second half of 2022, weighed down by the higher cost and lower availability of financing, combined with valuation uncertainty. Global deal volume reached a ten-year low, totaling $645 billion.

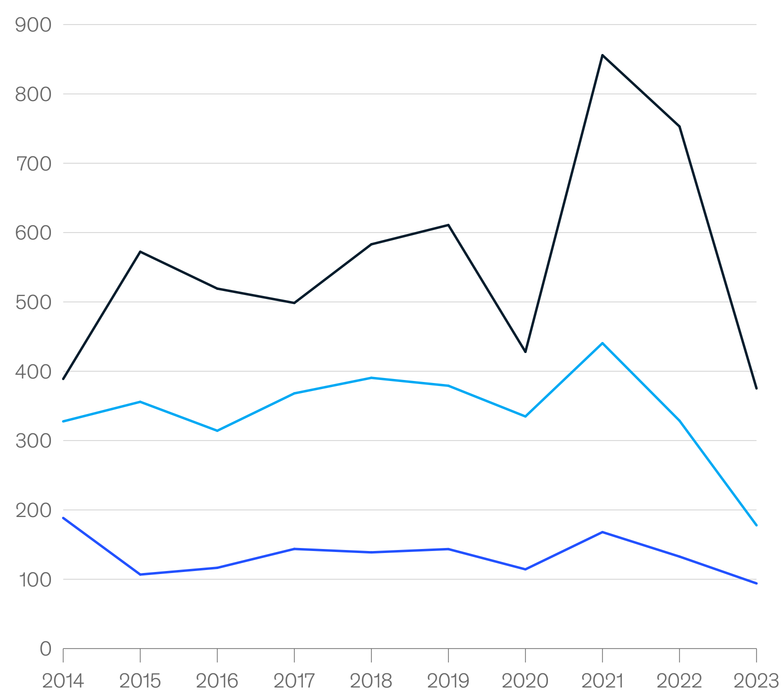
In the Americas, deal volume fell to a ten-year low, totaling $375 billion (Exhibit 29). Deal activity declined 29 percent to $94 billion in Asia–Pacific and 46 percent to $178 billion in EMEA.

The interest rate environment has left the real estate market in a state of suspended animation. Demand uncertainty and rising interest rates have made price discovery challenging, and the widening bid–

Exhibit 29

Global deal volume fell 47 percent.

Global real estate deal volume, $ billion



	2018–23 CAGR, %	2022–23 growth, %
Total	–10.3	–46.7
Americas	–8.4	–50.2
EMEA	–14.6	–45.9
Asia–Pacific	–7.5	–29.2

Source: CBRE; Real Capital Analytics

McKinsey & Company

[17] CoStar.

ask spread between would-be buyers and sellers has made it exceedingly difficult to transact. While sellers may be anchored to valuations calculated in a low-interest-rate environment and are reluctant to adjust downward, buyers face increased borrowing costs and anticipated economic headwinds.

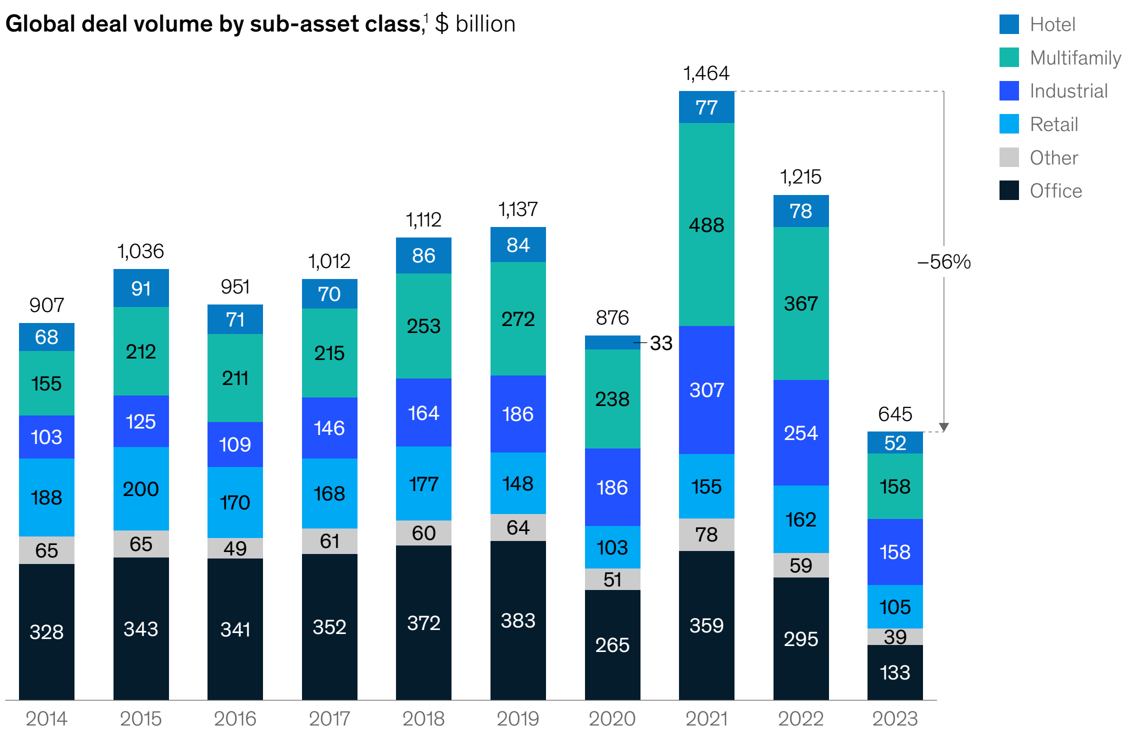
There is reason to believe that the bid–ask spread will narrow in the not-so-distant future. Bidding activity increased in late 2023, with the average number of bids per deal rising 16 percent.[18]

Global deal activity declined across all major sectors (Exhibit 30). Multifamily and industrial deal volume declined 57 and 38 percent in 2023, respectively, the second consecutive year of declines after reaching record highs in 2021. Meanwhile, office sector deals fell 55 percent, reaching a ten-year low of $133 billion. Prior to the mass adoption of hybrid work, office deals had represented the plurality of market volumes (see sidebar "Lasting effects of the pandemic on global real estate"). Now, with continuing uncertainty in sectoral demand, price discovery remains a substantial challenge.

Exhibit 30

Real estate deal volume declined across every major sub-asset class.

Global deal volume by sub-asset class,[1] $ billion



[1]Commercial deal volume; excludes residential.
Source: CBRE; Real Capital Analytics

McKinsey & Company

[18] Erik Sherman, "The many implications of the narrowing bid–ask gap," *GlobeSt*, January 16, 2024.

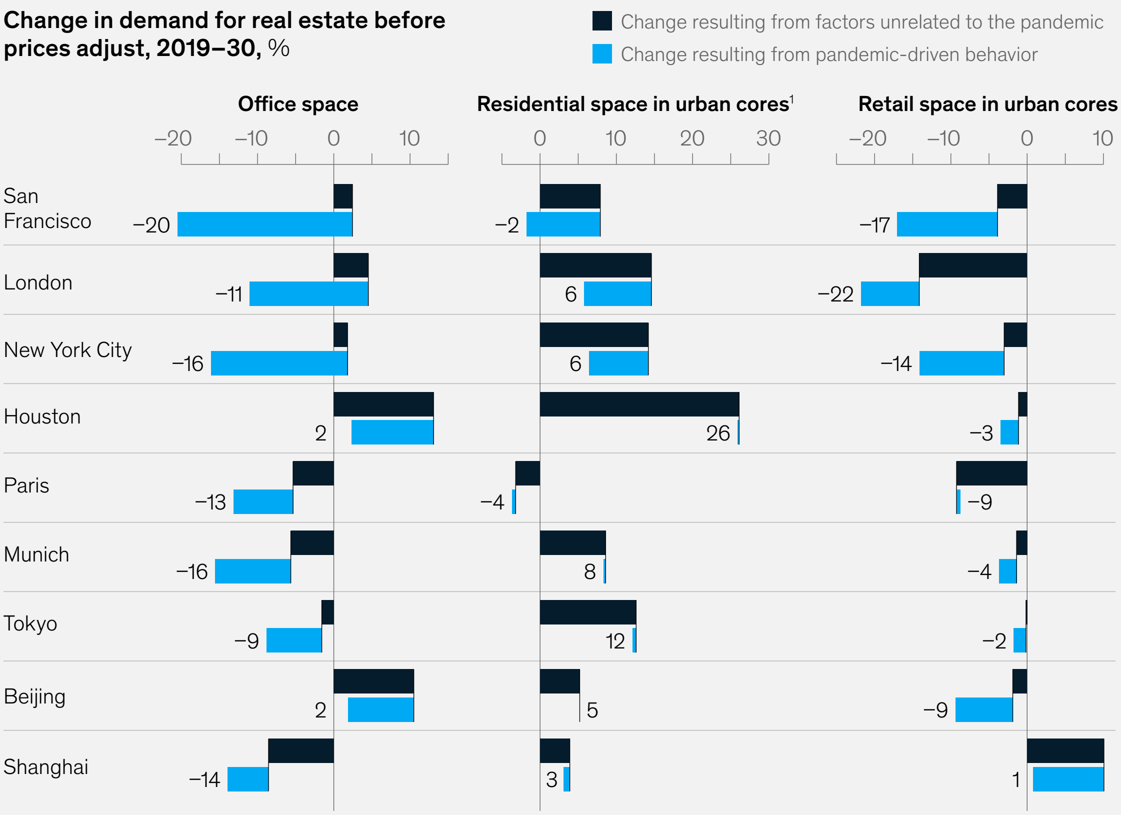
Lasting effects of the pandemic on global real estate

The behavioral changes caused by the pandemic—lower office attendance, accelerated migration out of cities, and less shopping in office-heavy neighborhoods—will reduce demand for real estate in most superstar cities (those with a disproportionate share of the world's urban GDP and GDP growth). In a moderate scenario modeled by the McKinsey Global Institute,[1] demand for office space in the median city studied is expected to be 13 percent lower in 2030 than it was in 2019. In a severe scenario, demand is expected to fall by 38 percent in the most heavily affected city. Similarly, demand for retail space in the superstar urban cores could be lower in 2030 than it was in 2019. In San Francisco's urban core, for example, the moderate scenario forecasts demand being 17 percent lower (exhibit), and the severe scenario forecasts a 26 percent decrease.

Demand for residences in superstar urban cores, before accounting for price adjustments, could be up to 10 percent lower by 2030 than it would have been without the pandemic. That said, the demand for residential space in urban cores will remain higher than it was in 2019 in every city studied, except San Francisco and Paris. That estimate rests on the assumption that, although the wave of residents who left urban cores may not return, population growth in each city will return to its prepandemic rate by 2024. If population growth remains depressed longer, the impact on demand could be bigger.

Exhibit

In a moderate scenario, demand for office and retail space falls sharply from 2019 to 2030.



Note: For more information about the scenario, see the technical appendix.
[1]Demand for residential space in superstar cities is highly price elastic, so in the long run, these shifts would probably lead to a rebalancing of prices rather than an actual reduction in demand.
Source: Beijing Municipal Bureau of Statistics; BNP Paribas; Colliers; Commercial Real Estate Intelligence Solutions; CoStar; Department for Levelling Up, Housing and Communities (United Kingdom); E&G Real Estate; E-Stat (Japan); Eurostat; EW & Associates Realty; Federal Statistical Office (Germany); German Property Partners; Kastle; Ministry of Beijing; Mitsui Fudosan; National Institute of Statistics and Economic Studies (France); National Statistics Institute (Spain); Office for National Statistics (United Kingdom); RealAdvisor; Sanko Estate Company; Shanghai Municipal Bureau of Statistics; Statistics Bureau of Japan; Tokyo Metropolitan Government; US Bureau of Labor Statistics; US Census Bureau; McKinsey Global Institute analysis

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[1] For the full McKinsey Global Institute report and to read more about the pandemic's effects on real estate and the implications for global demand, see "Empty spaces and hybrid places: The pandemic's lasting impact on real estate," McKinsey Global Institute, July 13, 2023.

US markets by sector

Performance in the multifamily sector in the United States declined last year due to expanding cap rates and softening rent growth. Deal volume was down 61 percent to $118 billion from $305 billion in the prior year and well below the record high of $358 billion in 2021 (Exhibit 31). Multifamily assets collectively produced a trailing one-year return of –7.3 percent and have returned 6.0 percent per year over the trailing three-year period, as of the end of 2023.[19] Due to increased apartment supply in key geographies, vacancy rates have increased to a ten-

Exhibit 31

Deal volume declined across all real estate sectors in the US.

		Multifamily	Industrial	Retail	Office	Hospitality
Deal volume	Total 2023, $ billion	**118**	**89**	**57**	**52**	**26**
	Total 2022, $ billion	306	160	93	117	49
	YoY change, %	–61	–44	–38	–55	–47
Development as a % of supply	Total 2023, %	**4.9**	**2.4**	**0.5**	**1.2**	**2.6**
	Total 2022, %	5.9	3.8	0.5	1.5	2.7
	YoY change, pp	–1.0	–1.4	0.0	–0.3	0.1
Occupancy[1]	Total 2023, %	**92.4**	**94.3**	**96.0**	**86.5**	**63.0**
	Total 2022, %	93.5	96.1	95.8	87.6	62.6
	YoY change, pp	–1.1	–1.8	0.1	–1.1	0.4
Absorption	Total 2023, units/square feet	**324**[3]	**166**	**53**	**–55**	**NA**
	Total 2022, units/square feet	148[3]	418	76	–7	NA
	YoY change, %	118	–60	–30	–709	NA
RevPAR[2] **growth**	Total 2023, %	**1.5**	**4.6**	**1.5**	**–5.3**	**NA**
	Total 2022, %	4.6	25.6	4.9	–3.7	NA
	YoY change, pp	–3.1	–21	–3.4	–1.6	NA
Cap rate	Total 2023, %	**5.7**	**5.1**	**7.3**	**10.7**	**8.6**
	Total 2022, %	5.1	4.6	6.5	7.9	8.5
	YoY change, pp	0.6	0.5	0.8	2.7	0.1
Returns	Total 2023, %	**–7.3**	**–4.1**	**–0.9**	**–17.6**	**10.3**
	Total 2022, %	7.1	14.4	2.7	–3.4	9.6
	YoY change, pp	–14.4	–18.5	–3.6	–14.2	0.7

[1]Average of 12-month occupancy for hospitality.
[2]Revenue per available foot.
[3]Net residential units absorbed, thousands of units.
Source: CoStar; Green Street; National Council of Real Estate Investment Fiduciaries Property Index; Real Capital Analytics

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[19] National Council of Real Estate Investment Fiduciaries (NCREIF).

year high of 7.6 percent.[20] However, the United States continues to remain structurally short of three million to four million housing units, as conservatively measured by Freddie Mac. More housing, particularly affordable housing, is needed to bridge this gap.

The industrial sector continues to cool from 2021 highs, which resulted from the pandemic-driven surge in e-commerce. Tenant demand has since slowed, resulting in a deceleration of rent price growth. In 2023, industrial deal volume fell to a five-year low of $89 billion. According to the National Council of Real Estate Investment Fiduciaries' NPI Index, industrial assets produced a trailing one-year return of –4.1 percent and have now returned 16.4 percent per year over the trailing three-year period. Meanwhile, absorption and leasing activity fell below prepandemic levels after two frenzied years: 166 million net square feet were absorbed during the year (down 60 percent year over year), and 810 million net square feet were leased (down 18 percent year over year).[21] Industrial vacancy rates rose to 5.7 percent in the fourth quarter of 2023 from 3.9 percent in the fourth quarter of 2022, and rent growth fell to 6.4 percent, declining by four percentage points over the same period.

The office sector remains under pressure from persisting demand uncertainty. Vacancy rates increased in the ten largest US office markets to a record-setting 16 percent.[22] Though employee attendance may be stabilizing at approximately 50 percent of prepandemic levels in the ten largest US cities, economic demand remains uncertain. Office assets collectively returned –17.6 percent over the last year and have now returned –5.5 percent per year over the trailing three-year period. The rise in interest rates has reduced construction activity, resulting in limited new supply after current projects complete. This scarcity may significantly tighten the premium space market within a few years.

The hospitality sector was a bright spot in 2023. According to NCREIF's NPI index, it was the only major real estate sector that recorded positive returns last year, achieving a trailing one-year return of 10.3 percent. The sector has now returned 8.6 percent per year over the trailing three-year period. Deal volume decreased by roughly 47 percent year over year. However, despite recording positive year-over-year performance, hospitality returns declined over each successive quarter, potentially as a result of the softening of the postpandemic rush in leisure travel and sustained decline in corporate travel associated with remote working. Meanwhile, the trailing 12-month revenue per available room (RevPAR) has consistently increased month over month, after a pandemic low in February 2021, helped in part by the inflationary pressure on average daily room rates (ADRs).[23]

Finally, the retail sector remained relatively resilient amid economic uncertainty. In 2023, demand grew across an array of retail subsectors, store closures slowed, and minimal new supply supported occupancy. Still, retail's performance was underwhelming, posting a trailing one-year return of –0.9 percent (although the sector recorded the second-strongest returns among major real estate sectors after hospitality) and returning 2.0 percent per year over the trailing three-year period. At the same time, however, retail fundamentals have continued to improve over time. Demand for retail space in the United States grew more than 18 million square feet during the fourth quarter of 2023, the 11th consecutive quarter of demand growth.[24] Consequently, availability of retail space was 4.8 percent in the fourth quarter of 2023, the lowest ever recorded and 160 basis points below the ten-year historical average of 6.4 percent. In such an environment, tenants have reported difficulty finding space: the trailing four-quarter leasing activity fell to 199 million square feet as of the fourth quarter of 2023, nearly 20 percent below the average of 237 million square feet recorded for 2015–19.

[20] CoStar.
[21] Ibid.
[22] The markets are Boston, Chicago, Dallas, Houston, Los Angeles, New York City, San Francisco, San Jose, Seattle, and Washington, DC.
[23] CoStar.
[24] Ibid.

Transforming real estate with generative artificial intelligence

Generative AI (gen AI) has taken center stage at a crucial time for the real estate industry. With softening demand and rising cap rates, real estate firms are fast recognizing that many applications of gen AI can enhance the operating performance of assets, improve processes, and ultimately increase returns (see sidebar "Real estate use cases for gen AI").

McKinsey Global Institute (MGI) estimates that gen AI could generate $110 billion to $180 billion or more in value for the real estate industry.[25] AI-forward players can generate meaningful increases in net operating income (NOI) through more efficient operating models, stronger customer experience, tenant retention, new revenue streams, and smarter asset selection.

Real estate use cases for gen AI

Already, real estate players can enable several key use cases for gen AI:

— *Sifting through mountains of leasing documentation.* Gen AI can analyze complex lease documents, making it easier for property owners and investors to find information at scale. The tool can summarize key themes, such as monthly rent and market factors, and generate tables of information based on specific parameters, like rent price per square foot. Professionals can then review the compiled information provided by the AI tool.

— *Copiloting real estate interactions.* Gen AI can be used to create a powerful copilot——an AI-powered bot for various real estate interactions, including tenant requests and lease negotiations. The copilot can handle simple tenant requests such as routine maintenance by directly contacting the building's maintenance staff. For more complex questions, the copilot can flag tenant needs for a specialist at a property management company.

— *Enabling visualization and creating new revenue streams.* Gen AI tools can help potential tenants visualize exactly what an apartment would look like in, say, their preferred midcentury modern style or in cherrywood versus walnut finishes. This data can then be fed back into a model to predict which types of furnishings and finishes work best for different customer segments, which could improve prospect-to-lease conversion and shape future capital expenditure decisions.

— *Making faster, more precise investment decisions.* Today, investment decisions are often informed through individual analysis of bespoke data pulls across sources. Gen AI can overlay this multi-faceted analysis on a list of properties for sale to identify and prioritize specific assets meeting criteria for manual investigation.

— *Drawing architectural plans known to create desired outcomes.* A gen-AI-assisted process can introduce Internet of Things sensors and computer vision algorithms that collect data points on space use, such as how customers move through a store before purchase or when conference rooms are used in an office. The gen AI tool can then help develop architectural plans that are optimized to create desired outcomes in a space. Human architects and designers can work from these plans to ensure art and emotion in the design with less guesswork over whether a space is purpose driven.

Gen AI will not replace analytical AI; for some use cases (such as producing a rent forecast or a retention prediction), more traditional machine learning excels. Rather, gen AI is opening up never-before-possible use cases relevant to portions of the real estate value chain that technology did not previously touch.

[25] For more about gen AI and its potential role in the real estate industry, see Matt Fitzpatrick, Vaibhav Gujral, Ankit Kapoor, and Alex Wolkomir, "Generative AI can change real estate, but the industry must change to reap the benefits," *McKinsey Quarterly*, November 14, 2023. For more about its potential impact across industries, see "The economic potential of generative AI: The next productivity frontier," McKinsey, June 14, 2023.

4 Private debt pays dividends

During a turbulent year for private markets, private debt was a relative bright spot, topping private markets asset classes in terms of fundraising growth, AUM growth, and performance. Fundraising for private debt declined just 13 percent year over year, nearly ten percentage points less than private markets overall. Despite the decline in fundraising, AUM surged 27 percent to $1.7 trillion. And private debt posted the highest investment returns of any private asset class through the first three quarters of 2023.

Private debt's risk/return characteristics are well suited to the current environment. With interest rates at their highest in more than a decade, current yields in the asset class have grown more attractive on both an absolute and relative basis, particularly if higher rates sustain and put downward pressure on equity returns. The built-in security derived from debt's privileged position in the capital structure, moreover, appeals to investors that are wary of market volatility and valuation uncertainty.

Direct lending continued to be the largest strategy in 2023, with fundraising for the mostly-senior-debt strategy accounting for almost half of the asset class's total haul (despite declining from the previous year). Separately, mezzanine debt fundraising hit a new high, thanks to the closings of three of the largest funds ever raised in the strategy.

Over the longer term, growth in private debt has largely been driven by institutional investors rotating out of traditional fixed income in favor of private alternatives. Despite this growth in commitments, LPs remain underweight in this asset class relative to their targets. In fact, the allocation gap has only grown wider in recent years, a sharp contrast to other private asset classes, for which LPs' current allocations exceed their targets on average. According to data from CEM Benchmarking, the private debt allocation gap now stands at 1.4 percent, which means that, in aggregate, investors must commit hundreds of billions in net new capital to the asset class just to reach *current* targets.

Private debt was not completely immune to the macroeconomic conditions last year, however. Fundraising declined for the second consecutive year and now sits 23 percent below 2021's peak. Furthermore, though private lenders took share in 2023 from other capital sources, overall deal volumes also declined for the second year in a row. The drop was largely driven by a less active PE deal environment: private debt is predominantly used to finance PE-backed companies, though managers are increasingly diversifying their origination capabilities to include a broad new range of companies and asset types.

Fundraising

Global private debt fundraising fell 13 percent to $190 billion (Exhibit 32). Fundraising declined across geographies: in North America, which accounts for over half of the global total, fundraising fell by 15 percent, while fundraising in Europe and Asia declined 31 and 16 percent, respectively.

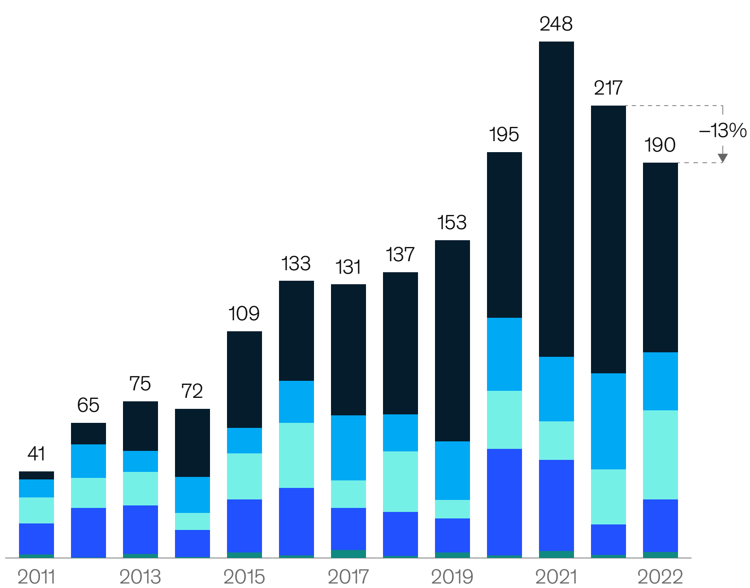
Fundraising for closed-end direct lending strategies decreased 29 percent from the prior year to $91 billion. Direct lending—the largest private credit strategy by a considerable margin—has driven the preponderance of fundraising growth for the asset class over the past decade. Dollars have accrued to the strategy in search of high (floating-rate) yields, with downside protection driven by a senior position in the capital stack. However, the slowdown in PE buyout activity and wariness over the potential for increased default and loss rates may have reduced investor appetite in the current environment.

Fundraising for special situations strategies declined as well, falling 39 percent to $28 billion. The decline follows the three highest fundraising years on record for the strategy from 2020 to 2022. Supply-side timing (that is, which large funds are in market) and a backlog of dry powder are partially to blame.

Exhibit 32

Private debt fundraising declined 13 percent.

Global private debt fundraising by strategy,[1] $ billion



	2018–23 CAGR, %	2022–23 growth, %
Total	6.7	–12.6
Direct lending	6.0	–29.2
Special situations	9.4	–39.4
Mezzanine	8.0	62.2
Distressed debt	3.4	69.5
Venture debt	27.4	127.1

[1]Excludes secondaries, funds of funds, and co-investment vehicles.
Source: Preqin

McKinsey & Company

In contrast, fundraising for mezzanine funds increased 62 percent to $43 billion, the highest total ever raised for the strategy. Three of the four largest mezzanine managers closed a fund in 2023, collectively accounting for more than 80 percent of all fundraising for the strategy during the year. The growth of mezzanine lending since 2021 indicates that investors may perceive the strategy's flexibility to be especially relevant at this point in the credit cycle.

Lastly, distressed fundraising recovered from an eight-year low in 2022, increasing 70 percent to $25 billion in 2023. The increase may reflect a belief among some LPs that higher interest rates and other macroeconomic headwinds will contribute to an improved deployment and return environment for the strategy in the near to medium term.

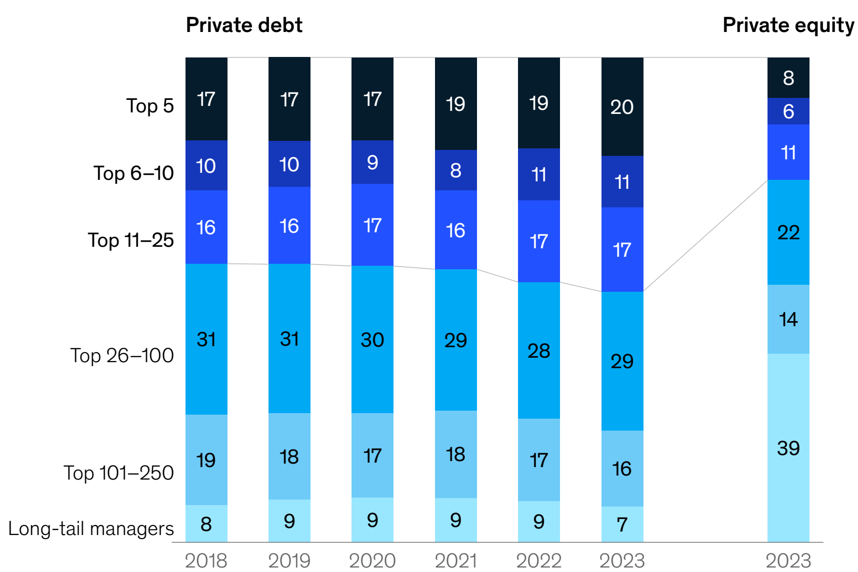
Consistent with other asset classes, investors concentrated their commitments in 2023 with larger debt funds and managers. Eight funds of $5 billion or more closed during the year (including the largest private debt fund ever raised, at $17 billion), collectively accounting for 38 percent of total fundraising. The top 25 managers, meanwhile, captured nearly three-quarters of all fundraising last year.

Private debt has exhibited a steady, gradual increase in fundraising concentration. On a trailing five-year basis, the top 25 managers in private debt captured 48 percent of all commitments in 2023, 6 percentage points more than in 2018 (Exhibit 33). This evolution is perhaps unsurprising, as performance and fee levels are lower in debt than in equity strategies, making scale more critical to manager profitability. Scale also breeds competitive advantage: lenders with deeper pockets are more capable of offering borrowers various financing solutions, providing liquidity on short notice, and holding larger positions across various capital sleeves without taking on undue concentration risk.

Exhibit 33

Private debt fundraising became more concentrated in 2023.

Trailing 5-year cumulative fundraising, % by fund manager rank



Note: Figures may not sum precisely due to rounding.
Source: Preqin

McKinsey & Company

AUM

Private debt AUM increased 27 percent over the prior year to $1.7 trillion. North America remains the largest region, accounting for 62 percent of the total global AUM, roughly 2.4 times larger than Europe. Private debt strategies remain nascent in Asia, which accounts for just 7 percent of the global total.

Performance

In uncertain market conditions, private debt continued to provide investors with more consistent returns than other asset classes. The pooled net IRR for private debt for the first three quarters of 2023 was 5.1 percent (6.8 percent annualized), the highest among all private asset classes.[26]

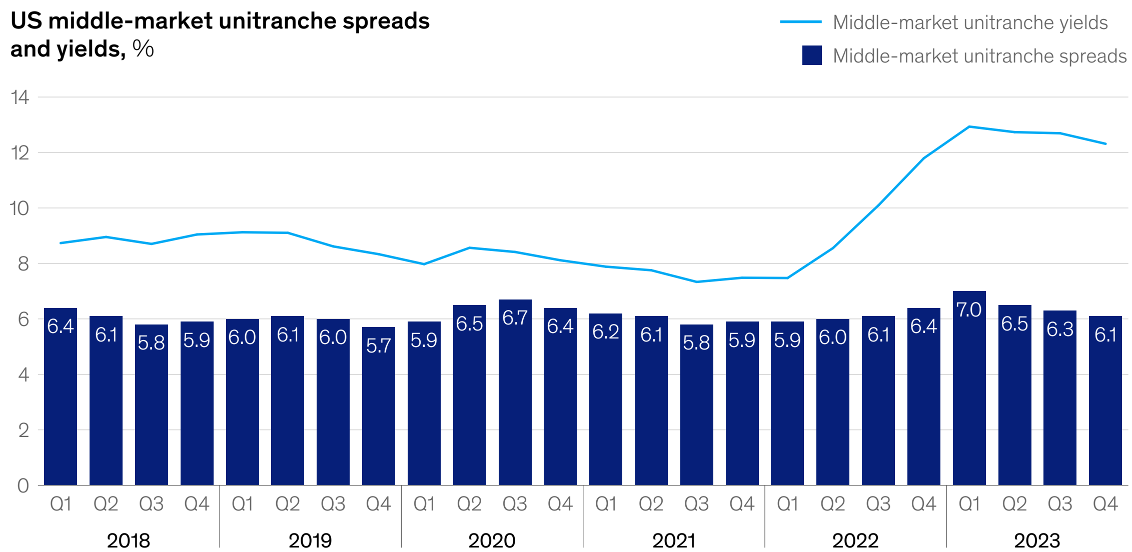
Direct lending yields peaked in the first quarter of 2023, as an acute regional banking crisis and fears of larger contagion drove spreads to their highest levels in at least five years. Banks and syndicated lenders returned to the market later in the year, driving spreads back in line with recent historical levels. Altogether, accounting for the impact of base rates that rose gradually throughout the year, yields on new middle-market unitranche loans remained above 12 percent for all of 2023 (Exhibit 34).

Over the long term, private debt has produced modest but consistent returns relative to other private asset classes. The 2011–20 vintages, for example, generated a median net IRR of 9 percent through September 30, 2023, slightly below that of real estate and roughly seven percentage points below PE. However, variance in returns among these private debt funds, as measured by the interquartile spread, is the lowest across asset classes (five percentage points), less than half of the dispersion among real estate funds and a third of that generated by PE funds.

Exhibit 34

Direct lending yields remained elevated through 2023.

US middle-market unitranche spreads and yields, %



Source: LSEG LPC

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[26] MSCI Private Capital Solutions.

Return profiles vary significantly across private debt strategies (Exhibit 35). Senior credit, predictably, has delivered both the lowest median returns (8 percent) and the lowest dispersion among funds, with a tight 3.5-percentage-point spread between the top and bottom quartiles. Distressed and mezzanine strategies have produced higher median returns with higher volatility. Mezzanine outperforms distressed across all quartiles but with slightly higher dispersion across funds.

Deal activity

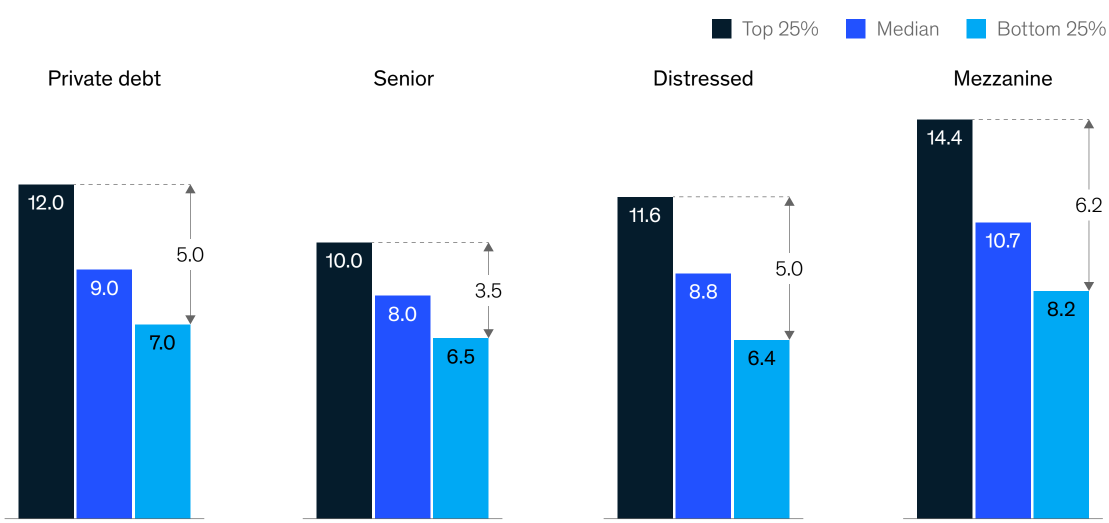
Comprehensive data on private debt deal volumes across strategies and geographies is limited by the opaque nature of activity in the space. In sponsored direct lending (private loans to PE-backed companies), available data suggests deal volumes declined 16 percent to $187 billion from the prior year (Exhibit 36). The decline was mostly a result of reduced financing volumes for leveraged buyout (LBO) transactions, despite private lenders increasing their market share in this segment to an all-time high of 59 percent in 2023.[27]

In non-buyout transactions, capital deployment was roughly flat year over year, indicating that, while direct lending deal volume remains highly levered to PE activity, it is not wholly dependent on LBOs for deployment opportunities. Much of the non-LBO deployment in 2023 served to refinance existing private or syndicated facilities, partly for borrowers repricing outstanding facilities to take advantage of lower spreads in the second half of the year. Another common driver of refinancing came from borrowers opting to extend in advance of an approaching maturity. This trend is likely to accelerate in 2024 and 2025, given that nearly $1.4 trillion of speculative-grade loans and bonds are maturing in the next three years.[28]

Exhibit 35

Private debt has produced modest yet low-volatility returns over the long term.

Private debt performance by strategy, median IRR and quartile spreads for 2011–20 vintage funds,[1] %



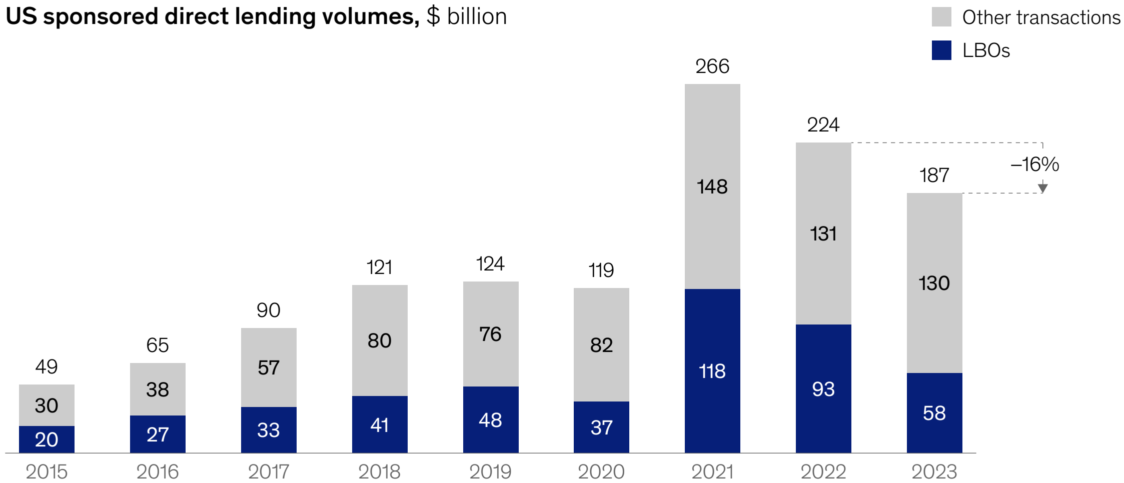
[1]IRR spreads calculated for funds within vintage years separately and then averaged. Median IRR was calculated by taking the average of the median IRR for funds within each vintage year; net IRR to date through Sept 30, 2023.
Source: MSCI Private Capital Solutions

McKinsey & Company

[27] LSEG LPC.
[28] S&P Global as of January 1, 2024. Includes nonfinancial corporate loans and bonds rated BB+ or lower by S&P Global Ratings.

Exhibit 36

Sponsored direct lending volumes declined 16 percent.



Note: Figures may not sum precisely because of rounding.
Source: LSEG LPC

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Private debt's expanding footprint

The principal narrative underlying private debt's rapid growth over the past decade has been that of private lenders stepping into the void created by banks' exodus from the financing of highly leveraged businesses. Direct lenders have been the primary beneficiary of this trend, with AUM in the strategy growing a remarkable 15-fold, more than 30 percent per year, over the last ten years. Direct lending has been so newsworthy, in fact, that the term is now often used interchangeably with private credit as a whole, despite the latter encompassing a much broader set of strategies.

While the preceding pages detail several of these strategies (mezzanine, distressed, special situations), at least two are captured in other chapters of this report: private real estate debt and private infra-structure debt. Though these strategies are small relative to their equity counterparts—16 percent of total real estate AUM and 12 percent of total infrastructure AUM, respectively—their share is growing: the comparable figures in 2012 were just 8 and 5 percent.[29] Growth in these real assets financing strategies has been driven by many of the same factors as growth in corporate private debt, including bank retrenchment (to a lesser extent thus far) and LPs' quest for higher returns among their yield-oriented investments. Furthermore, as interest rates have increased, so have absolute returns available in real assets debt. Although these returns, due to the tangible nature of the collateral, are generally lower than those for corporate private debt, they have become more likely to clear GPs' return hurdles.

Private debt GPs are also extending into various forms of asset-based lending, including consumer credit, equipment leasing, and a wide range of other tangible and intangible asset types. Most of

[29] Preqin.

these assets are still predominantly financed by banks. In certain verticals, however, current market conditions and the impact of Basel III Endgame on bank capital requirements are creating a void in the market similar to that which emerged in leveraged lending more than a decade ago. Auto, unsecured consumer, and student loans are among the loan types most likely to transition away from bank balance sheets in the coming years.

In certain areas, banks' desire to preserve the value of their lending franchises has led to an element of "co-opetition" between banks and GPs. In most of these structures (notable examples of which were also announced in corporate private debt over the past year), the bank maintains the origination relationship with the borrower while entering into a "forward flow" agreement with a capital partner that ultimately funds the loan. Such an arrangement provides the GP with instant origination, which is generally considered to be the most differentiating component of the private credit value chain.

5 Infrastructure and natural resources take a detour

For infrastructure and natural resources fundraising, 2023 was an exceptionally challenging year. Aggregate capital raised declined 53 percent year over year to $82 billion, the lowest annual total since 2013. The size of the drop is particularly surprising in light of infrastructure's recent momentum. The asset class had set fundraising records in four of the previous five years, and infrastructure is often considered an attractive investment in uncertain markets.

While there is little doubt that the broader fundraising headwinds discussed elsewhere in this report affected infrastructure and natural resources fundraising last year, dynamics specific to the asset class were at play as well. One issue was supply-side timing: nine of the ten largest infrastructure GPs did not close a flagship fund in 2023. Second was the migration of investor dollars away from core and core-plus investments, which have historically accounted for the bulk of infrastructure fundraising, in a higher rate environment.

The asset class had some notable bright spots last year. Fundraising for higher-returning opportunistic strategies more than doubled the prior year's total. AUM grew 18 percent, reaching a new high of $1.5 trillion. Infrastructure funds returned a net IRR of 3.4 percent in 2023; this was below historical averages but still the second-best return among private asset classes. And as was the case in other asset classes, investors concentrated commitments in larger funds and managers in 2023, including in the largest infrastructure fund ever raised.

The outlook for the asset class, moreover, remains positive. Funds targeting a record amount of capital were in the market at year-end, providing a robust foundation for fundraising in 2024 and 2025. A recent spate of infrastructure GP acquisitions signal multi-asset managers' long-term conviction in the asset class, despite short-term headwinds. Global megatrends like decarbonization and digitization, as well as revolutions in energy and mobility, have spurred new infrastructure investment opportunities around the world, particularly for value-oriented investors that are willing to take on more risk.

Fundraising

Global fundraising for infrastructure and natural resources fell 53 percent to $82 billion (Exhibit 37). The decrease in fundraising came on the heels of a record 2022 and a decade of consistent growth that was briefly interrupted during the early stages of the pandemic.

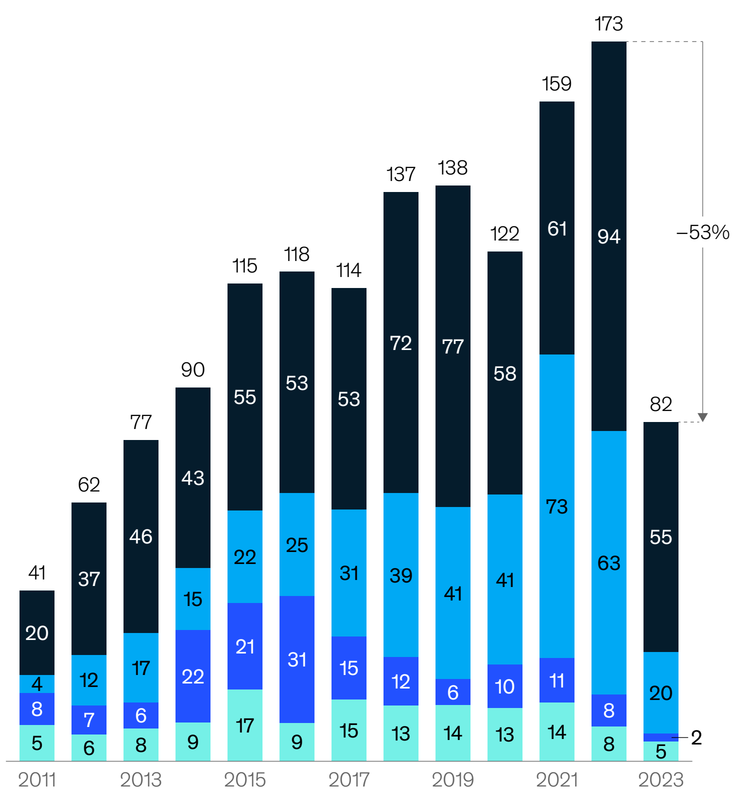
Infrastructure fundraising was likely impacted by the same factors that lowered overall private markets' capital haul, including economic uncertainty and the denominator effect. According to CEM Benchmarking, LPs' actual allocations to infrastructure, on average, were roughly in line with their 3.1 percent target for the asset class as of the beginning of 2023—the first time in a decade that LPs were not meaningfully under-allocated.

The timing of fund launches was another factor contributing to slower fundraising. Infrastructure characterized by significant supply-side concentration, so the timing of a handful of funds can have an outsized impact on annual fundraising totals. Just five funds, for instance, accounted for nearly half of 2022's record fundraising haul. In 2023, only one of the ten largest infrastructure managers closed a flagship fund (which was, notably, the largest infrastructure fund ever raised, at $28 billion). Many

Exhibit 37

Infrastructure and natural resources fundraising declined 53 percent.

Global infrastructure and natural resources fundraising by region,[1] $ billion



	2018–23 CAGR, %	2022–23 growth, %
Total	–9.8	–52.9
North America	–5.2	–41.0
Europe	–13.1	–69.1
Asia	–30.0	–74.1
Rest of world	–18.8	–43.9

Note: Figures may not sum precisely because of rounding.
[1]Excludes secondaries, funds of funds, and co-investment vehicles.
Source: Preqin

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of these managers are currently in the market with funds expected to close within the next two years, making it likely that 2023 was more of an aberration than the start of a new trend.

Fundraising declines were broad based by region. North America fell 41 percent to $55 billion, Europe declined 69 percent to $20 billion, and Asia fell 74 percent to $2 billion. The decline in fundraising in North America may be understated, and that in other geographies overstated, because many large vehicles categorized as North American have a global mandate and are likely to deploy some portion of their capital in Europe or Asia.

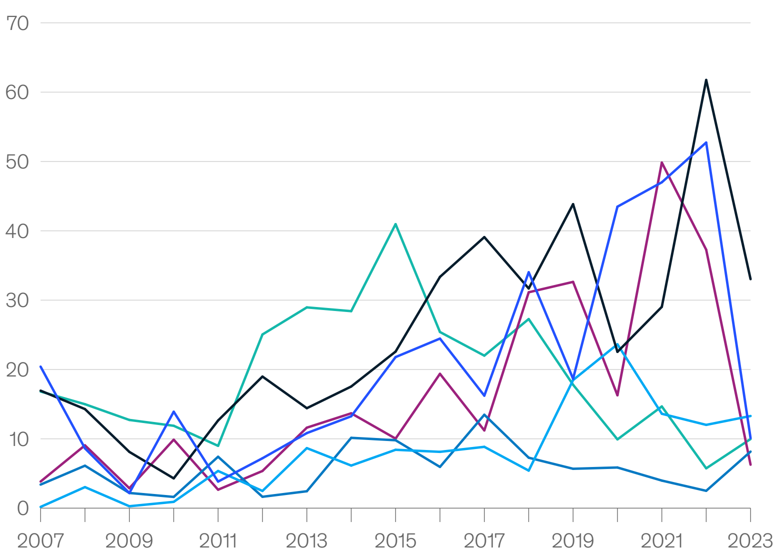
The decline in infrastructure fundraising was driven by dramatic decreases in its three largest strategies. The long-dated, fixed-return investments that characterize core and core-plus strategies fell out of favor (81 and 47 percent decline, respectively, from the previous year), largely because of the higher-interest-rate environment (Exhibit 38). Additionally, infrastructure value-added fundraising declined 83 percent year over year and represented just 8 percent of fundraising volume, after accounting for 23 percent of aggregate infrastructure and natural resources fundraising in the five years preceding 2023.

Other strategies fared better. Fundraising for infrastructure opportunistic funds was up more than 200 percent, infrastructure debt fundraising increased 11 percent, and natural resources fund-raising grew 74 percent. However, since funds targeting these strategies are comparably fewer and smaller, even rapid growth on a percentage basis was not enough in absolute terms to meaningfully offset the declines in the larger strategies.

Exhibit 38

Fundraising for the three largest infrastructure strategies declined in 2023.

Global infrastructure and natural resources fundraising by strategy,[1] $ billion



	2018–23 CAGR, %	**2022–23 growth,** %
Infrastructure core plus	0.8	–46.5
Infrastructure debt	19.7	10.7
Infrastructure core	–21.6	–80.9
Natural resources	–18.2	73.7
Infrastructure opportunistic	2.3	226.4
Infrastructure value-added	–27.4	–83.2

[1]Excludes secondaries, funds of funds, and co-investment vehicles; excludes funds with undefined strategy (approximately 1 percent of fundraising).
Source: Preqin

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AUM

Infrastructure and natural resources AUM grew to $1.5 trillion as of June 30, 2023, up 18 percent from the prior year. Geographically, 80 percent of the AUM is concentrated in the United States and Europe.

Performance

The pooled net IRR for infrastructure funds for the first three quarters of 2023 was 3.4 percent, well below the historical median performance of 10.2 percent.[30] The lower performance is largely attributable to declining asset valuations, as the long-dated fixed cash flows that characterize many infrastructure investments became less valuable in a rising-rate environment.

Meanwhile, natural resources funds generated a pooled net IRR of 1.7 percent through September 30, 2023, a stark contrast to the double-digit returns generated by the strategy in 2021 and 2022.[31] One cause of the underperformance was sharp decreases in energy prices. Crude and natural gas prices, which had more than doubled from 2020 to 2022, fell significantly in 2023, with average WTI crude prices down 18 percent and Henry Hub natural gas prices down 61 percent.[32]

Looking ahead

Despite 2023's lackluster fundraising and performance results, infrastructure and natural resources continue to benefit from strong tailwinds. The energy transition continues apace and will require enormous amounts of capital that cannot be met by public funding alone. The rapid advancement of generative AI applications that require high processing power has further amplified demand for digital infrastructure. Capital buildout in the United States and several other large economies has become a government priority that crosses party lines, with many incentives and spending programs launched to support such initiatives.

To capitalize on these opportunities in the current market environment, infrastructure managers are shifting their focus toward strategies further out on the risk-return spectrum. Value creation has become an increasingly large part of the investment thesis in many infrastructure investments, and investors are expanding beyond core infrastructure and logistics into other deal types, such as platforms and scale-ups. Crossover deals, including carve-outs and PE-to-infra deals that involve acquiring corporate targets with infrastructure-like characteristics (for example, data center cooling services, pallet pooling solutions) are becoming more common. Growth infrastructure is another burgeoning area, as evidenced by the launch of several funds focused on scaling smaller companies in sectors that include electric vehicle charging, modular data centers, and biofuel.

[30] MSCI Private Capital Solutions.
[31] Ibid.
[32] US Energy Information Administration (EIA).

6 Private markets make measured progress in DEI

Diversity, equity, and inclusion (DEI) has become an important part of the fundraising, talent, and investing landscape for private market participants. Encouragingly, incremental progress has been made in recent years, including more diverse talent being brought to entry-level positions, investing roles, and investment committees. The scope of DEI metrics provided to institutional investors during fundraising has also increased in recent years: more than half of PE firms now provide data across investing teams, portfolio company boards, and portfolio company management.[33]

In 2023, McKinsey surveyed 66 global private markets firms that collectively employ more than 60,000 people for the second annual *State of diversity in global private markets* report. The research offers insight into the representation of women and ethnic and racial minorities in private investing as of year-end 2022. In this chapter, we discuss where the numbers stand and how firms can bring a more diverse set of perspectives to the table.

[33] "The state of diversity in global private markets: 2023," McKinsey, August 22, 2023.

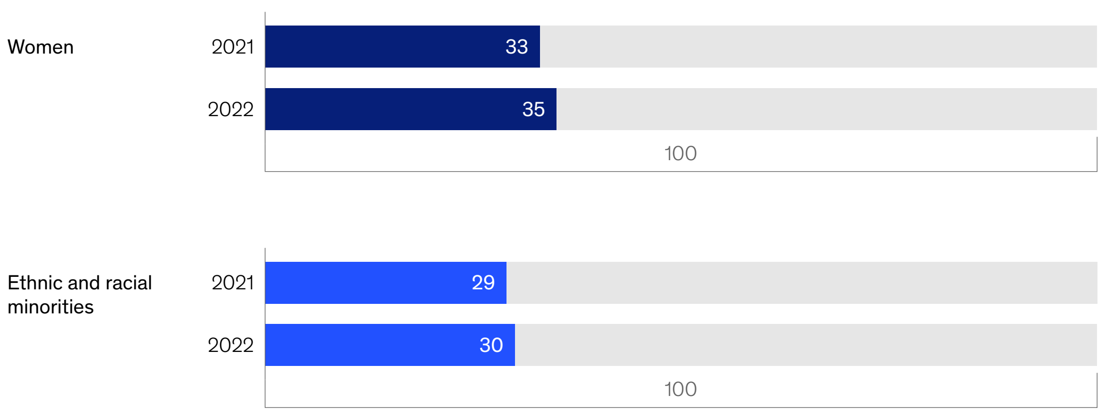
The statistics indicate signs of modest improvement. Overall representation of women in private markets increased two percentage points to 35 percent, and ethnic and racial minorities increased one percentage point to 30 percent (Exhibit 39). Entry-level positions have nearly reached gender parity, with female representation at 48 percent. The share of women holding C-suite roles globally increased 3 percentage points, while the share of people from ethnic and racial minorities in investment committees increased 9 percentage points. There is growing evidence that external hiring is gradually helping close the diversity gap, especially at senior levels. For example, 33 percent of external hires at the managing director level were ethnic or racial minorities, higher than their existing representation level (19 percent).

Yet, the scope of the challenge remains substantial. Women and minorities continue to be under-represented in senior positions and investing roles. They also experience uneven rates of progress due to lower promotion and higher attrition rates, particularly at smaller firms. Firms are also navigating an increasingly polarized workplace today, with additional scrutiny and a growing number of lawsuits against corporate diversity and inclusion programs, particularly in the US, which threatens to impact the industry's progress.

Exhibit 39

Private markets firms made incremental progress on DEI.

Global representation of women[1] and ethnic and racial minorities,[2] % of employees[3]



[1]Across all role types (investing, operating, non-investing).
[2]Across investing roles.
[3]Based on data provided by 41 PE firms. Responses cover more than 22,000 employees. Unique firm count by region: Americas = 37, Europe = 24, Asia–Pacific = 16.
Source: McKinsey's 2022 and 2023 State of Diversity in Global Private Markets

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Representation of women across private markets

Globally, women in PE were better represented than in the prior year. However, they continued to be underrepresented in leadership positions, reflecting historical imbalances in entry-level representation, lack of promotion parity, and higher attrition rates than for men.

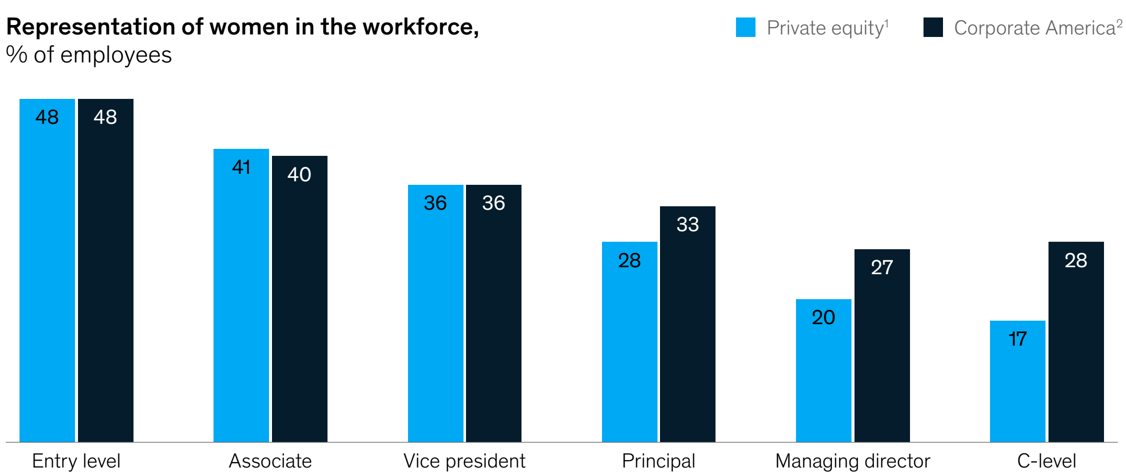
As of year-end 2022, 48 percent of entry-level roles in PE were held by women, similar to their representation in corporate America (Exhibit 40). However, the gender gap widened at senior levels. Representation of women in corporate America was seven percentage points higher than in PE at the managing director level and 11 percentage points higher at the C-suite level.

While women continue to be well represented in most non-investing roles, gender parity remains distant in investing and operating roles (Exhibit 41). In entry-level positions, for example, women made up 59 percent of non-investing roles but just 33 percent of investing roles. Representation also falls steeply with seniority: the percentage of women in investing roles at the principal level, for instance, was just 16 percent, 17 percentage points lower than entry-level representation and 35 percentage points below non-investing principal representation.

The industry made some modest gains in 2022. The share of C-suite roles held by women globally increased 3.5 percentage points to 17 percent. Similarly, representation of females in post-MBA investing associate roles—often a second entry point—increased to 29 percent, while

Exhibit 40

Compared with corporate America overall, PE has lower representation of women at senior levels.



[1]Based on data provided by 41 PE firms. Responses cover more than 22,000 employees. Unique firm count by region: Americas = 37, Europe = 24, Asia–Pacific = 16.
[2]Based on data provided by 276 participating organizations and more than 27,000 employees.
Source: McKinsey's 2023 State of Diversity in Global Private Markets; McKinsey's 2023 Women in the Workplace

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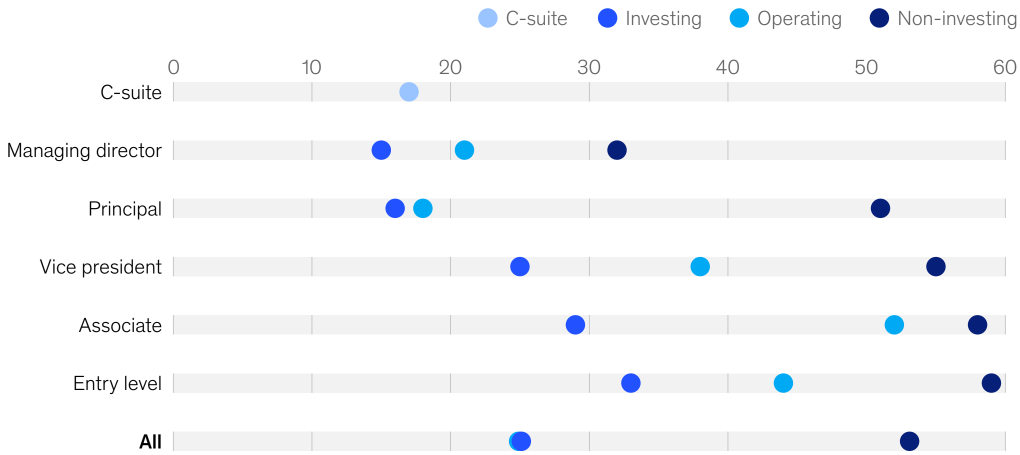
Exhibit 41

Women are underrepresented in investing roles at every seniority level.

Representation of women in each seniority level, global PE industry,[1]
% of women in role and level



[1]Based on data provided by 41 PE firms. Responses cover more than 22,000 employees. Unique firm count by region: Americas = 37, Europe = 24, Asia–Pacific = 16.
Source: McKinsey's 2023 State of Diversity in Global Private Markets

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representation at the managing-director level went up to 15 percent. Although women's representation in investment committees also has improved in recent years, women still made up only 12 percent of IC members in 2022.

Manager size appears to play a significant role in gender diversity. Firms with more than $100 billion in AUM are leading the charge toward gender parity in investing roles. Roughly 27 percent of their investing professionals are women, slightly above the global benchmark of 25 percent. These larger firms also have a much higher proportion of women in entry-level investing roles than those with $5 billion to 25 billion in AUM (38 percent versus 26 percent).

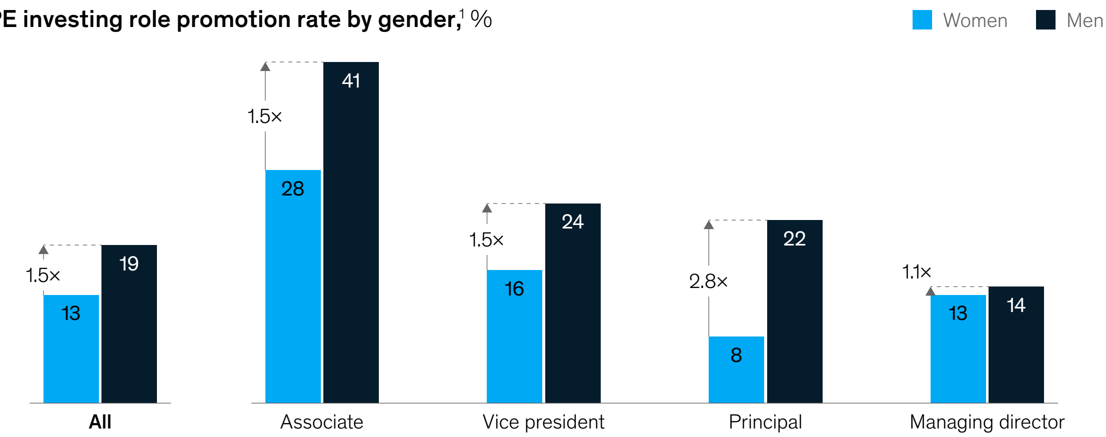
At almost every level, women in investing roles were promoted at significantly lower rates than men (Exhibit 42), and they continue to find themselves navigating a longer route to reach the same milestones as their male colleagues. Globally, men in investing roles were about 50 percent more likely, on average, to be promoted than their colleagues who are women. Turnover is also higher among women, whether for lack of promotion or other reasons. The global attrition rate for investing positions was 16 percent for women, four percentage points above the rate for men.

Differences early in the funnel can often result in a "broken rung" that makes it harder to achieve parity at higher levels on the corporate ladder. So as the pipeline for the next generation of women leaders grows, external hiring will continue to be an important lever for reaching gender parity. On average, 34 percent of investing-track external hires into PE firms globally in 2022 were women (ten percentage points higher than female representation in investing roles at the start of the same year), signaling that a lateral hiring approach is helping to spur progress.

Exhibit 42

At every level of seniority, women in investing roles are less likely than men to be promoted.

PE investing role promotion rate by gender,[1] %



[1]Based on data provided by 41 PE firms. Responses cover more than 22,000 employees. Unique firm count by region: Americas = 37, Europe = 24, Asia–Pacific = 16. Promotion rates are calculated by dividing the number of women (or men) promoted into the level during the year by the total number of women (or men) at the lower level at the beginning of the year. Promotion rate is not calculated when the number of employees at the lower level is zero.
Source: McKinsey's 2023 State of Diversity in Global Private Markets

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Ethnic and racial representation across private markets

Overall representation for ethnic and racial minorities increased one percentage point from 2021 to 2022, though certain ethnic and racial minority groups continue to be underrepresented in the private markets. Over the past year, the most progress was made in the representation of ethnic and racial minorities on investment committees, which grew from 9 percent to 18 percent. Representation at the principal level also increased ten percentage points year over year.

Similar to women, ethnic and racial minorities have better representation in entry-level positions than in senior roles. In the United States and Canada, ethnic and racial minorities accounted for 30 percent of all investing roles in 2022 but just 19 percent of investing roles at the managing director level (Exhibit 43).

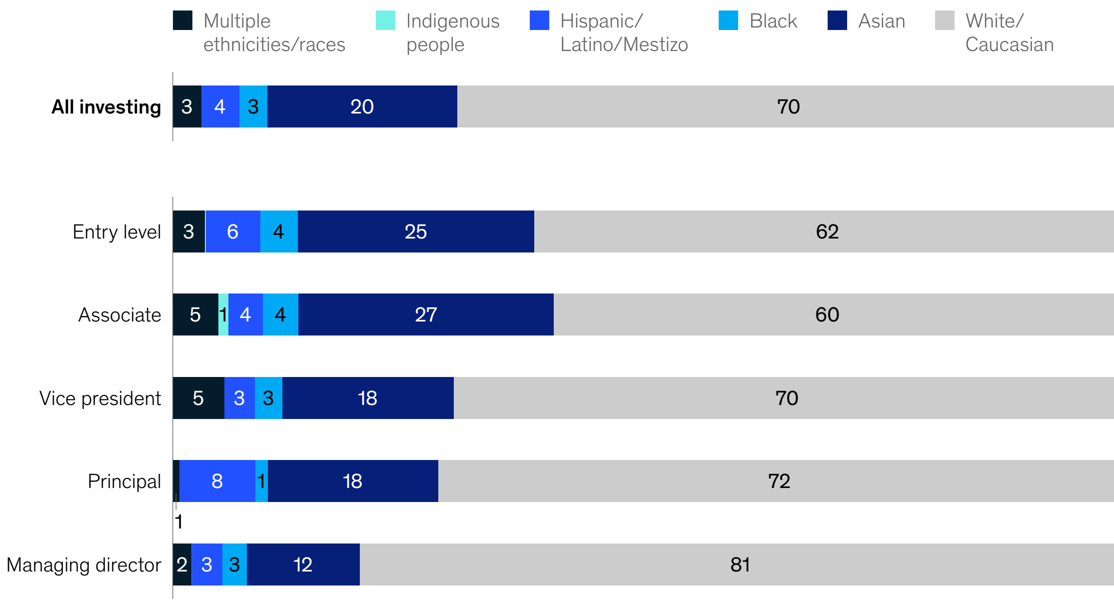
There are also significant variations among Asian, Hispanic, and Black professionals. Among racial minorities, Asian professionals held the largest share (20 percent) of all investing roles but just 12 percent of senior roles. Hispanic professionals held only 4 percent of all investing roles, and Black investing professionals—one of the most underrepresented ethnic and racial minorities—held no more than 4 percent of investing roles at any level.

Promotion and attrition rates also vary by ethnic and racial group. White professionals are promoted the most across every level except principal. At the managing director level, for example, White professionals are over 2.3 times more likely to be promoted than any other race or ethnicity. Meanwhile, Black PE investing professionals have the highest rates of attrition, especially in the junior roles, and are over 50 percent more likely to leave their organizations than their White and Asian colleagues, which underlines long-term challenges with

Exhibit 43

Representation of ethnic and racial minorities declines with seniority.

PE talent pipeline by ethnicity/race in US/Canada,[1] % of investing roles



Note: Figures may not sum precisely because of rounding.
[1]Based on data provided by 33 private equity firms. Responses cover more than 14,000 employees in the US and Canada.
Source: McKinsey's 2023 State of Diversity in Global Private Markets

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attracting and developing Black talent in the industry.

External hiring has a positive effect on increasing the representation of ethnic and racial minorities. In 2022, 33 percent of external hires at the managing director level and 31 percent at the principal level were ethnic or racial minorities—in both cases, higher percentages than the existing representation levels (19 and 28 percent, respectively).

The path forward

The DEI landscape in private markets is changing, in no small part as result of the push from LPs to share data on DEI metrics during fundraising. However, GPs' methods of calculating and reporting DEI vary considerably, as do the expectations and definitions of DEI held by LPs. The industry should look to address this variance in the coming years by implementing standardized, apples-to-apples approaches by which DEI progress can be tracked.

More importantly, it is crucial for firms to embed and promote diversity and inclusion practices in all levels of the organization. Private markets firms seeking to continue improving representation of women and racial and ethnic minorities have several levers they can pull:

— *Increase transparency with clear metrics and tracking capabilities.* Firms can appoint champions to lead the creation and tracking of attrition and promotion rates by gender, ethnicity, and race, where possible, along with other measures of diversity, to shed light on their effectiveness in retaining and promoting diverse talent.

— *Diversify recruitment and hiring.* To improve their hiring processes, firms can increase transparency and expand their hiring reach by diversifying their talent pool from universities, backgrounds, and geographies they may not have previously considered.

— *Debias the promotion processes.* Unconscious-bias and conscious-inclusion training minimizes the impact of unconscious prejudices on decision-making processes. To foster a more equitable promotion process, firms can be transparent about what is required for success in each role, with clearly defined objectives for advancement. Formal sponsorship and mentorship programs specifically for women and ethnic and racial minorities also can improve visibility in promotion processes.

— *Improve retention.* Firms can improve retention by fostering an equitable and inclusive culture. Employee resource groups, generous leave policies, remote work, and child care subsidies are some potential tools for creating a more inclusive environment. Creating intentional on-ramps and off-ramps for employees as they transition to and from parental leave or extended time off can help normalize these journeys.

The incremental progress across underrepresented groups, roles, and levels in private markets is certainly cause for optimism, but the work has just begun. The ongoing polarization around accelerating the pace of DEI initiatives across industries could cause disparate perspectives on how much DEI matters in the coming years. That variation is likely to have an impact on whether the industry can successfully shorten the time frame to reach parity.

For a deeper exploration on DEI issues across private markets, please see our 2023 State of Diversity in Global Private Markets report.[34] This annual study is one of the largest and most comprehensive studies of diversity in private markets firms globally. We invite private markets GPs and institutional investors to participate in our 2024 edition of the report. Please sign up here.

[34] "The state of diversity in global private markets: 2023," McKinsey, August 22, 2023.

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