

# HOUSE OF STICKS

What Private Markets managers can learn from their Public Markets peers to strengthen their business



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## INTRODUCTION / EXECUTIVE SUMMARY

It is a "Golden Age" for Private Markets investing.

Over the last decade, Australian investors have significantly increased their investments in private markets with allocations set to expand further. While the pace of growth in the private market asset classes of real estate, infrastructure, private equity, and private credit has not always been synchronous, the attractive, long-term factors of higher returns, diversification benefits, and the potential for inflation hedging have been consistent across all.

Notwithstanding the impressive growth in allocations to private markets in recent years, a critical observation is that in their operations and technology functions these investment managers and service providers have remained immature. In fact, there's a notable shortfall in leveraging this Private Markets era to invest in their own internal capabilities, outside of investments and business development, and secure their long-term sustainability.

Borrowing from the classic children's tale, The Three Little Pigs, instead of building a House of Bricks, many of these managers continue to operate within a House of Sticks.

To capitalise on the ongoing growth in allocations to private markets, as well as to address the increasingly targeted reviews from Australian regulators, private markets managers would be well advised to undertake a strategic review of their existing operating and governance models whilst heeding the lessons learned by their public market peers.

The experience from public market managers should not be ignored as they could signpost a more operationally challenging and less profitable future for private markets. The attractiveness of the private markets space has encouraged a sizable increase in the number of investment managers and products, as well as the building out of private market investment capabilities within superannuation funds. Increased competition and internalisation will lead to inevitable margin pressure.

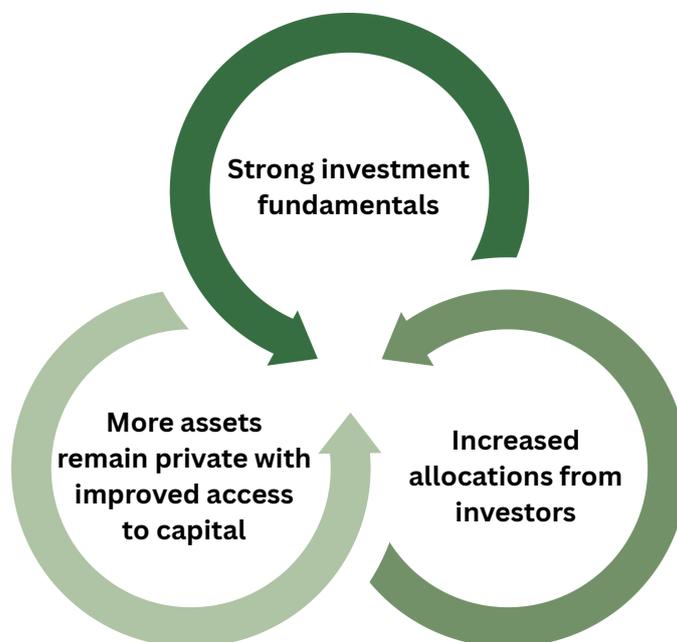
It is therefore incumbent on private market managers to use this moment to gain efficiencies in their operating models whilst also facilitating better investment decision-making. This is the opportunity to make hay while the sun is still shining on private markets.

By adopting best practices from public market managers, private market firms will improve their operations, strengthen governance frameworks, and ensure they are well-placed to continue to prosper in this Golden Age of private market investment.



# THE GOLDEN AGE FOR PRIVATE MARKETS

In this Golden Age for Private Markets, there are several factors that reinforce the success of the other dynamics and therefore the growth of the whole:



## STRONG INVESTMENT FUNDAMENTALS

Private market assets exhibit attractive, long-term investment fundamentals.

Firstly, investors gain access to private companies or assets or sectors that may not be traded or are less widely available through public markets, such as commercial real estate, infrastructure utilities, or early-stage venture capital.

Access to private market assets not only adds breadth to investment portfolios, it also offers diversification benefits. By providing exposure to asset classes and companies that behave differently from publicly traded assets, investors are able to reduce overall portfolio risk.

Investing in private market assets may also reduce overall portfolio volatility. Unlike public companies, where prices are marked to market every trading day, private asset valuations adjust more slowly, removing short-term noise and enhancing medium-term portfolio stability.

However, it is the potential for higher returns from private assets (setting aside the potential for higher risks and costs) that is the main driver for its attractiveness. Higher returns from these assets can be driven by exposure to leverage or the illiquidity premium. In supplying capital to these assets, investors may also be able to assert more control over their investment through direct engagement with management to influence strategy and thereby drive further value creation.

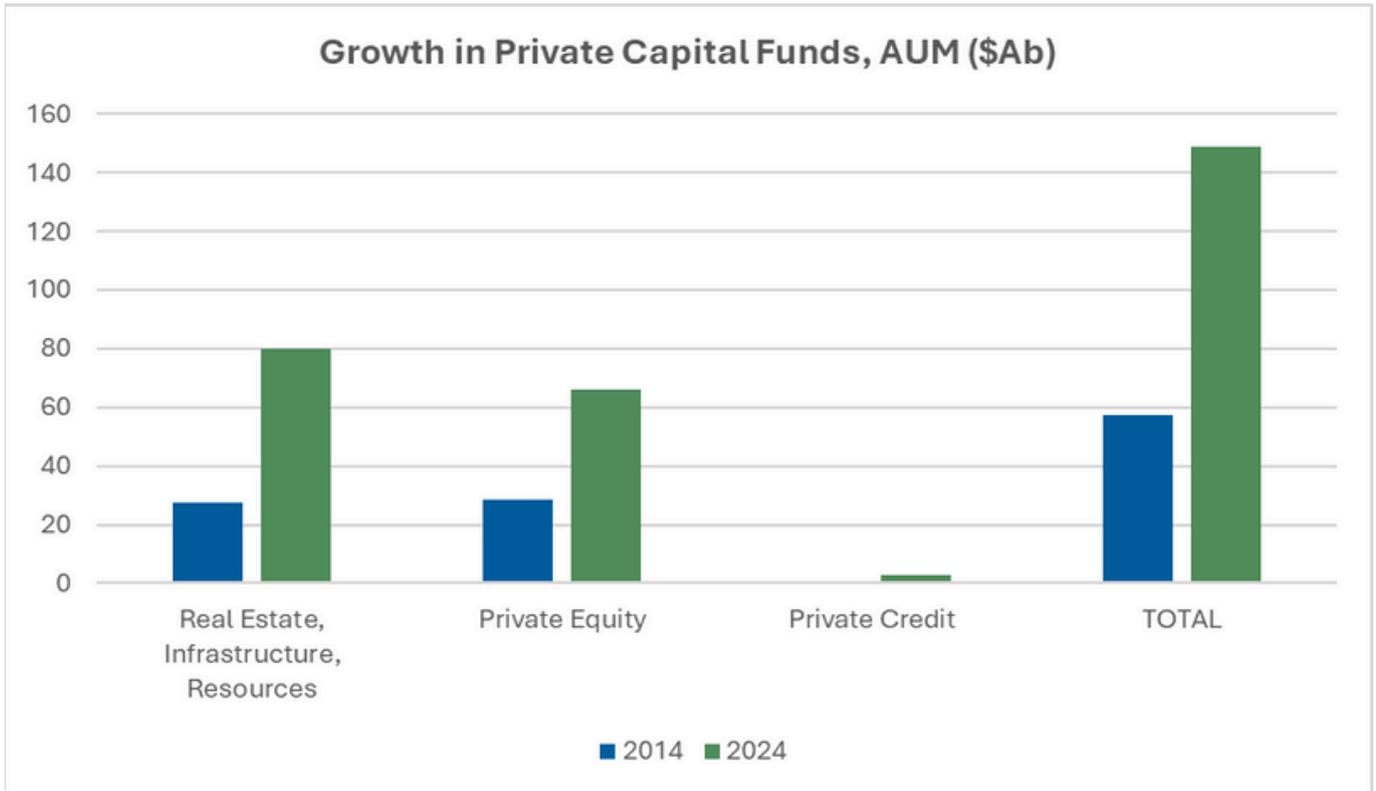


## INCREASED ALLOCATIONS FROM INVESTORS

These combined advantages foster strong investor confidence and have underpinned the sustained influx of capital into private market assets.

In Australia, private market growth has been significant. In the decade to September 2024, the overall assets under management (AUM) of private capital funds in Australia has increased over 160%<sup>1</sup>.

### TABLE HEADING



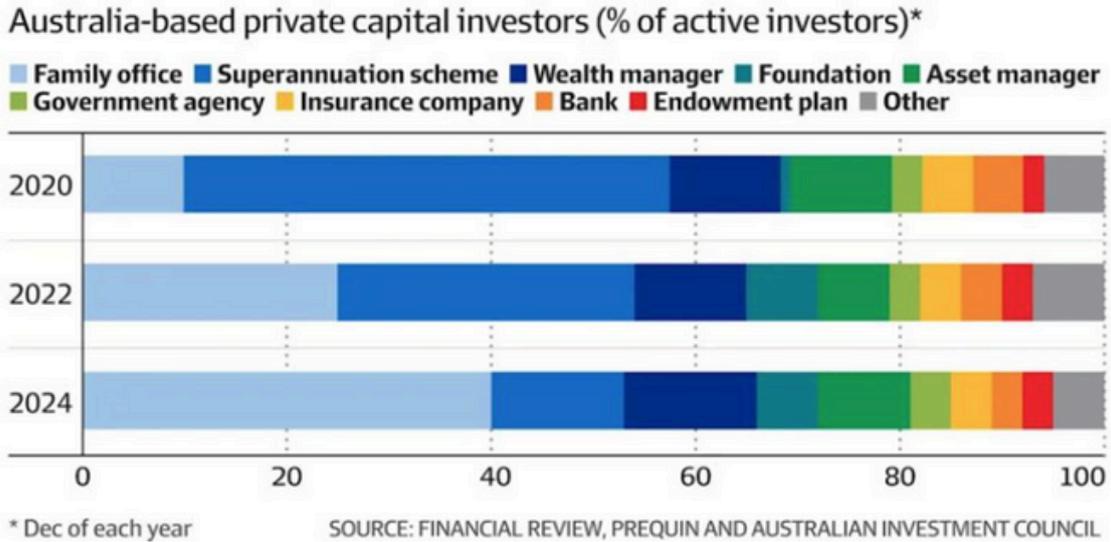
As the largest investor base in the Australian market, superannuation funds' investments in private markets now represent over 16% of their total portfolio, with some funds holding a substantially higher portion of their total holdings<sup>2</sup>. As represented in the table above, investments in unlisted real estate and infrastructure comprise the largest component, followed by private equity investments. While private debt has the smallest allocations, it is the fastest growing component of private market investments from super, albeit from a low base<sup>3</sup>.

While the weight of capital clearly favours the superannuation funds, they are far from the most active investors in private markets. The democratisation of private market investing through managed funds has seen a significant growth in allocations from private wealth investors, namely family offices, wealth managers, and foundations<sup>4</sup>.



These allocations are set for further growth with 52% of wealth managers looking to increase their allocation to private markets into the future<sup>5</sup>.

**TABLE HEADING**



## MORE ASSETS REMAIN PRIVATE WITH IMPROVED ACCESS TO CAPITAL

There has been a profound shift in how economic growth is financed, with much of the corporate growth cycle now occurring outside of public markets.

With the vastly improved access to private capital, companies are remaining private for longer (or are delisting to go from public funding to private financing). This abundance of capital allows companies to secure substantial capital through a variety of funding solutions without ceding strategic control or flexibility and allowing the focus to remain on long-term execution of the corporate plan.

The development and maturing of secondary markets for private assets also increases the liquidity available to investors, introducing new stakeholders with different risk and return profiles.



## TAILWINDS TO HEADWINDS?

Despite these significant tailwinds supporting private market investment managers, there is a chronic underinvestment in the operating foundations of their own businesses. This is not merely a local issue, but a global one. The challenges of operational inefficiency and the need for strategic internal investment are observed across private market managers worldwide.

There are several imperatives as to why managers need to address this:

# 1

Increased regulatory oversight of managed investment schemes investing in private markets, particularly of managers that are targeting retail and less sophisticated wholesale investors – this is covered more in the next section of the paper.

# 2

Acceleration of money flowing into private assets has encouraged scores of new entrants. This heightened competition for assets and for capital will likely decrease both investment returns (i.e., attractiveness of the manager) and also margins (i.e., profitability). It may also encourage managers to invest in lower quality or higher risk assets in order to generate an attractive return in line with past performance.

# 3

With more manager choice, firms that fail to invest in the improvement of their own operating platform, run the risk of being outmanoeuvred by the competition or unable to effectively manage their own expanding portfolios.

# 4

An isolated operational error may not indicate a systemic problem. However, an under-investment in operational capability could lead to multiple errors, remediation, and brand damage. These risks are often underestimated and very costly.

Private market investment firms must move beyond short-term profits and prioritise building robust, scalable, and sustainable internal structures to secure their future in this increasingly competitive and more highly scrutinised landscape.

## INCREASE IN REGULATORY OVERSIGHT

The growing allocations to private market assets, including their adoption by retail and less sophisticated wholesale investors, has compelled the regulators to seek assurance that manager practices are robust.

In its 2024–25 corporate plan, the Australian Securities and Exchange Commission (ASIC) put all market participants on notice with the inclusion of a strategic priority to drive consistency and transparency across public and private markets and products.

ASIC chair Joe Longo said: “While Australia’s private markets are dwarfed in size by our listed equity markets, their opacity presents an outsized risk to market integrity, particularly as more investors become exposed.”<sup>6</sup>

In theory, similar levels of transparency between public and private market assets sounds fair. In practice, this is much harder to deliver in private markets and may have a detrimental impact on overall returns. The distinctiveness of bilateral or private negotiations and the confidentiality of the underlying covenants agreed has the potential to place enormous commercial burdens on private market managers.

At the heart of these concerns – ensuring investors have access to appropriate information about their investment and liquidity through required disclosures in PDSs or IMs - must be balanced against sharing too much information and revealing confidential terms. It can be challenging to provide sufficient transparency for an investor to assess risk while protecting details on competitive terms and other confidential information.

The regulatory oversight is not limited to the retail or wholesale investor segment. The Australian Prudential Regulation Authority (APRA) has also upped the ante for banks, insurers and superannuation trustees to better manage operational risks and respond to business disruptions with its Prudential Standard CPS 230.





CPS 230 provides a foundation for APRA-regulated entities to enhance third party risk management as relating to oversight of material service providers, which includes its investment managers.

While a single manager may argue whether they would meet the definition of “material” service provider, there are two significant factors that are nonetheless observed:

1. The level of compliance is rising for all managers, and
2. The CPS 230 standard is agnostic on asset class – whether public or private.

On this last point, all managers must be able to clear the same due diligence hurdle that has been set by CPS 230. It is important to understand that this regulation has set the floor for all manager due diligence – and it should not be considered to be an aspirational ceiling. And, in our experience across the market, it is clear that Public Market managers, as a whole, are far further ahead of their private market peers in designing and implementing business models with robust operating and governance models, tools and processes that meet these higher diligence standards.





## LESSONS FROM PUBLIC MARKETS

Investors combining their capital in pooled structures has a long history, and when it commenced it was primarily the domain of the wealthy. While the first open-ended modern mutual fund that invested in stocks and bonds was created in the United States in 1924, it would take the stock market crash of 1929 to compel a passage of regulations in the following decade to safeguard investors.

Since that time, public market managers have been required to adopt rigorous governance structures to ensure transparency, accountability, and fair treatment across their product offerings. They have done this even though their investments are marked to market on a daily basis and there is less potential for conflicts to occur.

Public market managers have also long been compelled to prioritise operational efficiency, a necessity borne out from years of increased competition from passive managers, decreasing margins, and waning capital allocations. This persistent pressure has driven them to invest in technology solutions and automation in an effort to enhance productivity across their operations.

In building their own Houses of Bricks, an entire ecosystem of service providers and systems have evolved to support public market managers in improving their operations.

Since the Global Financial Crisis of 2008, there has been an exponential increase in investor demand for private market assets. Through pooled vehicles, these private market assets are no longer a choice reserved exclusively for institutional or high net wealth investors. As we have seen through history, what follows higher investor demand and allocation is increased regulatory oversight to ensure appropriate investor protections.

Private market managers can glean crucial insights from their public market counterparts, particularly concerning operational efficiency and governance.

There is also a different funds management mindset that is held by public markets participants. The first public markets mutual funds were designed to bring professional investment management to a broad number of investors. Accordingly, an established third-party capital culture and fiduciary mindset have been built over time and now exists within these firms.

As many private market firms were spun out of family offices or large institutions, the mindset has traditionally focused on protecting the “house” first and foremost. In building their funds management businesses, private market firms are strengthening their fiduciary focus which includes this operational and governance uplift.



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# BUILDING EFFICIENCY IN PRIVATE MARKET OPERATING MODELS

Building better efficiency in private market operating models hinges on three key and interrelated areas:

## 1. STRATEGY



It is important to understand what your competitive advantages are as a business. How is your product or service differentiated? What in your business is proprietary and likely to add value to your team, your partners, or your investors? Once this has been identified, you can now determine where the opportunities are to build internally or to outsource non-core functions, such as fund administration, to specialised third-party providers.

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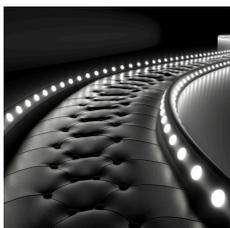
## 2. SYSTEMS



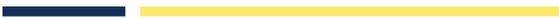
The technology servicing private markets continues to improve in its specialisation. Leveraging technology is essential for creating a centralised, single source of truth housing standardised and quality data that is accurate and consistent. This will not only support fund accounting, portfolio management, liquidity management, and investor reporting but it will improve oversight and decision-making by providing timely insights into performance and risks.

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## 3. STREAMLINING



There is little point in investing in technology without a corresponding investment in people and processes. Completing a review and documenting your core processes, such as the capital call and distribution workflow, will make business activities more seamless and intuitive. This will ensure that your organisation is aligned, and everyone has clear accountability in their roles.

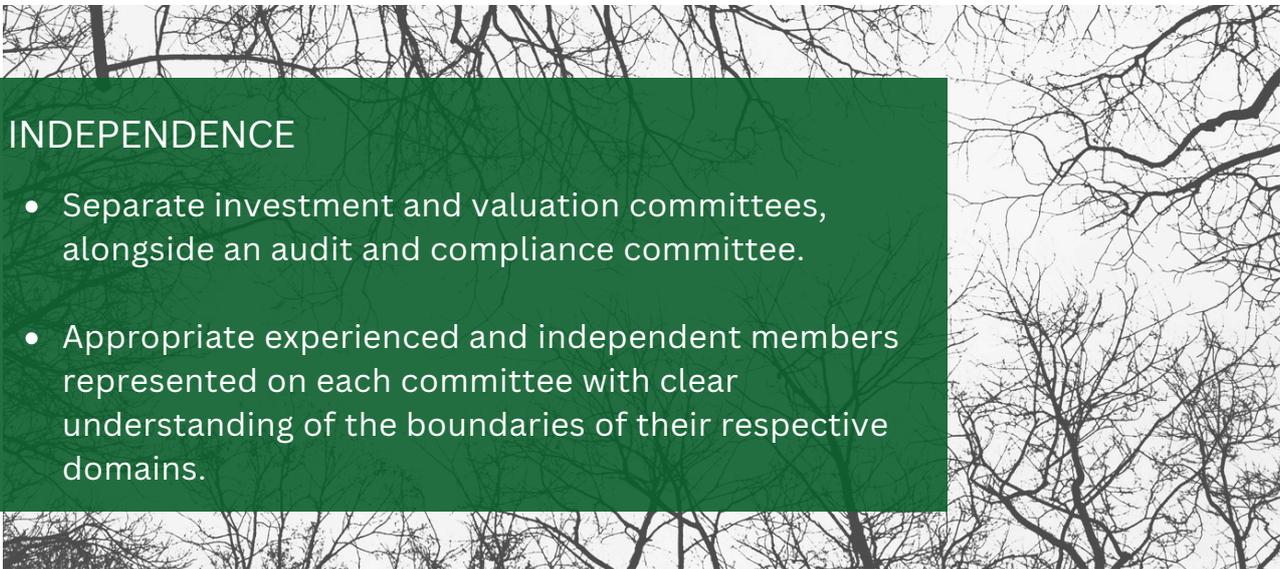


## IMPROVING GOVERNANCE IN PRIVATE MARKET OPERATING MODELS

There are core principles of governance – independence, transparency, fairness, disclosure, and accountability – that most would agree are mandatory for all investment managers as responsible fiduciaries.

However, there are complexities in private markets that may make these more difficult to manage. It does not follow that these can be ignored or overlooked.

In considering these governance principles, practical steps that a private markets manager may take include:



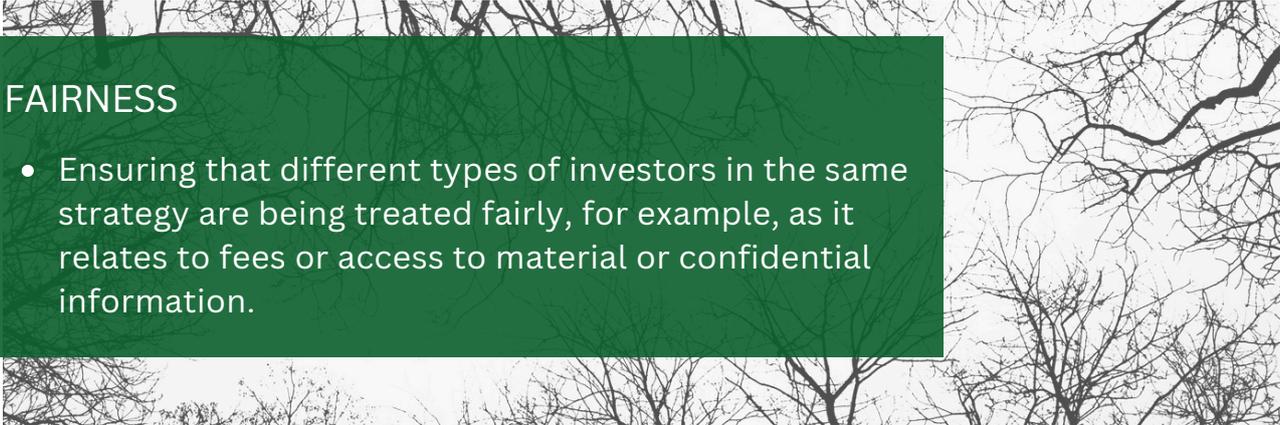
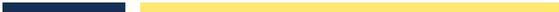
### INDEPENDENCE

- Separate investment and valuation committees, alongside an audit and compliance committee.
- Appropriate experienced and independent members represented on each committee with clear understanding of the boundaries of their respective domains.



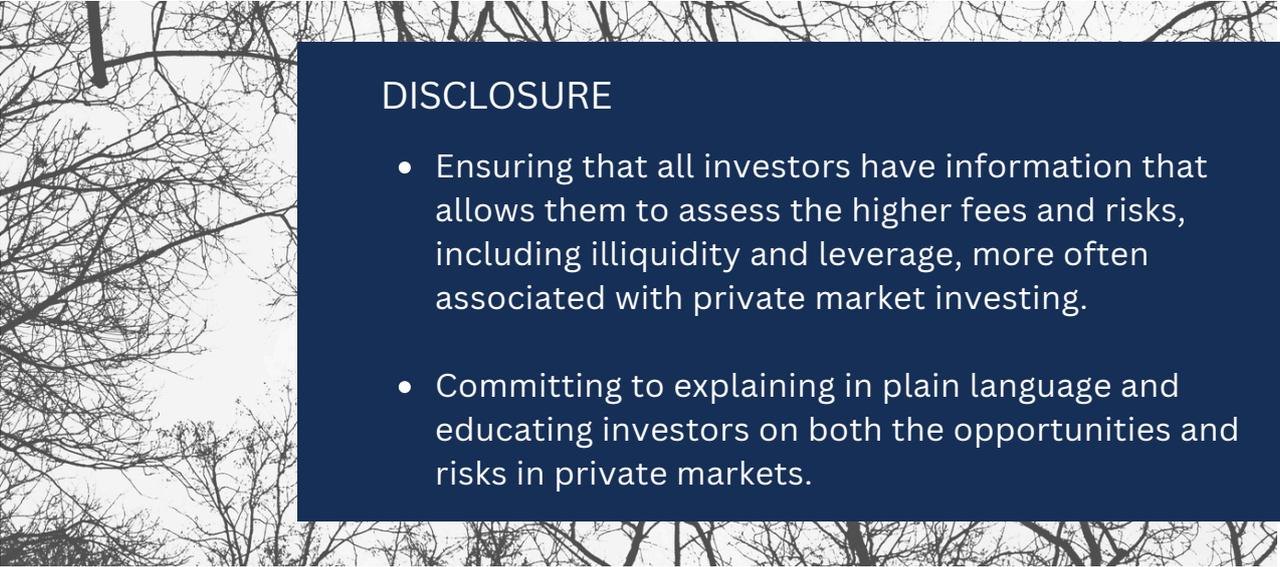
### TRANSPARENCY

- Clear policies on the management of conflicts of interest, including related party transactions and incentives.
- Clear valuation policies that also address frequency, when to use independent valuers, and specific guidelines for assets in distress.



## FAIRNESS

- Ensuring that different types of investors in the same strategy are being treated fairly, for example, as it relates to fees or access to material or confidential information.



## DISCLOSURE

- Ensuring that all investors have information that allows them to assess the higher fees and risks, including illiquidity and leverage, more often associated with private market investing.
- Committing to explaining in plain language and educating investors on both the opportunities and risks in private markets.



## ACCOUNTABILITY

- Changes in unit prices or asset values are signed off and implemented by the Operations or Finance team with oversight from valuation and compliance committees.

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## RECOMMENDATIONS AND CONCLUSION

While we are undeniably in a "Golden Age" for Private Markets investing, critical challenges persist. Despite this impressive growth, there is a notable shortfall in strategic internal investment by private markets managers.

They are operating in a House of Sticks, rather than a House of Bricks.

To capitalise on the structural tailwinds for private markets that underpin ongoing allocation to the asset class and to proactively address the increasingly targeted reviews from Australian regulators, it is imperative that private market managers consider a comprehensive strategic review of their existing operating and governance models.

This decisive action is essential to ensure they are robustly positioned to continue to prosper and maximise the opportunities presented by this Golden Age of private market investment.




## ENDNOTES

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# ABOUT MAVIN

Mavin Advisory Group (“Mavin”) is a specialist investment and wealth management consulting firm that provides tailored solutions to meet the unique needs of its clients. Founded by industry experts with a deep understanding of the evolving financial landscape, Mavin delivers compelling insights and innovative solutions to help clients achieve their strategic goals.

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