Net-to-LP Returns

Decomposing Fees, Carry and the True Cost of Alternatives

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May 2026

Abstract

Headline private market returns are quoted gross, but the only return that reaches a limited partner (LP) is the net return, after the management fee, the carried interest, the fund expenses and the transaction fees that the manager takes. The gap between gross and net, the fee drag, is large, compounds over the life of an investment, and varies widely across fund types and structures, yet it is routinely under-examined by investors dazzled by gross headline numbers. This paper decomposes net-to-LP returns for Gulf Cooperation Council (GCC) family offices and private-wealth investors, making the true cost of alternatives visible and showing how to manage it. It sets out the anatomy of private market fees, builds the gross-to-net bridge, shows how the fee drag compounds over a holding period, and compares fee structures from the traditional two-and-twenty to lower-fee and co-investment alternatives. It explains the carried-interest mechanics, the hurdle, the catch-up and the distribution waterfall, that determine how much carry a manager actually earns, and it surfaces the hidden costs, transaction fees, fund expenses, and fees charged on committed rather than invested capital, that erode the net return. It examines the measures of net return, the levers to improve it, the benchmarking of fees, and the considerations specific to the GCC. The analysis finds that the fee drag can consume a quarter to a third of the gross return over a fund life, that it varies materially across fund types and structures, and that a fee-aware investor that decomposes the net return, negotiates the terms, and uses the levers, above all co-investment, can keep materially more of the gross return than a fee-naive one. Three investor case studies, a sensitivity analysis, an international comparison and an implementation roadmap support the framework.

Keywords: Carried interest, fee drag, fees, GCC, limited partner, net returns, private markets, two-and-twenty

1. Introduction

Private market returns are quoted gross, but the gross return is not what an investor keeps. Between the gross return that the underlying investments produce and the net return that reaches the limited partner lies the fee drag, the management fee, the carried interest, the fund expenses and the transaction fees that the manager takes, and that drag is large, compounding over the life of an investment to consume a quarter or a third of the gross return. Yet investors routinely focus on the gross headline number, under-examining the fee drag that determines what they actually keep.

This paper decomposes net-to-LP returns, making the true cost of alternatives visible and showing how to manage it. The premise is simple but consequential: the only return that matters is the net return the investor keeps, and a sophisticated investor must understand and manage the fee drag that separates it from the gross. A family office that decomposes the net return, understands the fee components, and uses the levers to manage them can keep materially more of the gross return than one that accepts the headline gross number and pays the standard fees without examination.

The central argument is that the fee drag is large, compounds over time, and varies materially across fund types and structures, and that a fee-aware investor can keep materially more of the gross return by decomposing the net, negotiating the terms, and using the levers, above all co-investment, examined in a companion paper. The fee drag is the most controllable part of the net-return equation, and managing it is one of the most effective ways an investor can improve what it keeps, which is why understanding net-to-LP returns is central to investing in alternatives well.

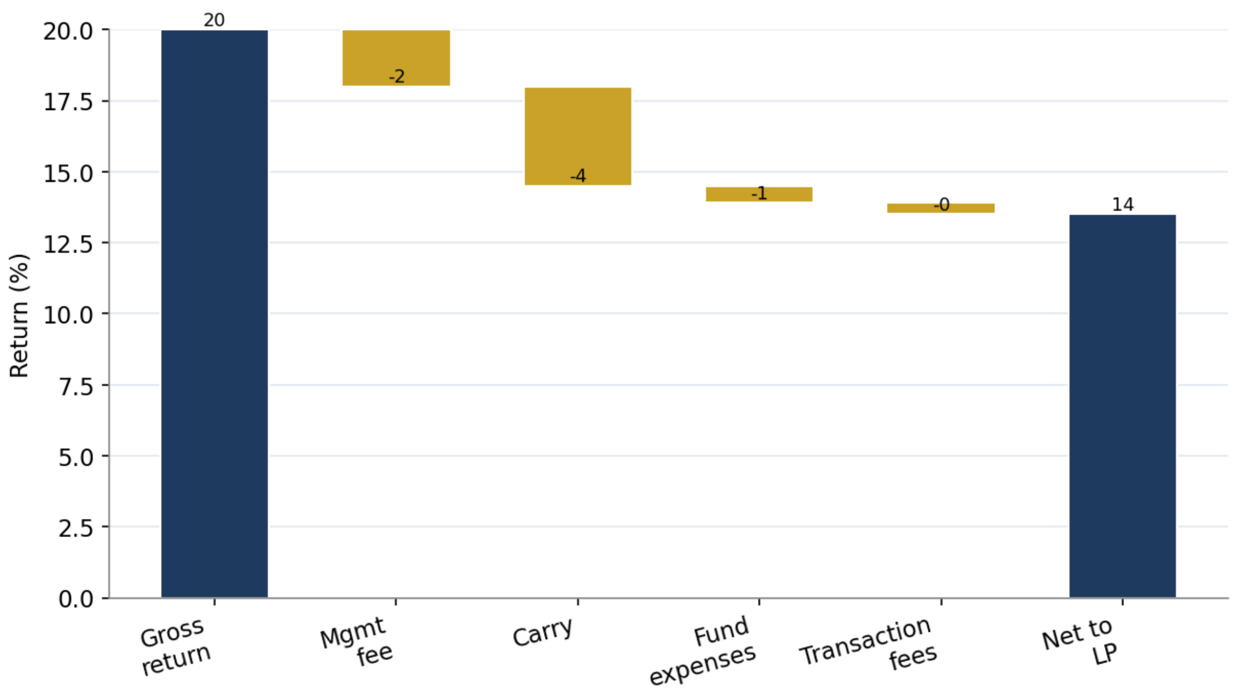
The paper complements the companion papers on building a private credit allocation, on direct versus fund investing, on co-investment, and on the J-curve, in which fees and net returns featured. Here the focus is specifically on decomposing and managing the net return, making the true cost of alternatives visible. The figures are modelled to illustrate the framework and are indicative. The paper proceeds from why net-to-LP is the only number that matters (Section 2), through the conceptual foundations (Section 3), the anatomy of fees (Section 4), the gross-to-net bridge (Section 5), how the drag compounds (Section 6), fee structures compared (Section 7), the carry mechanics (Section 8), the hidden costs (Section 9), measuring net returns (Section 10), the levers to improve them (Section 11), and benchmarking fees (Section 12), before turning to alignment, regional considerations, the GP perspective, cases, sensitivity, and implementation.

2. Why Net-to-LP Is the Only Number That Matters

The net-to-LP return is the only return that reaches the investor, and it is therefore the only number that matters for the investor wealth, yet it is routinely overshadowed by the gross headline number that managers quote. A manager may quote a gross return that sounds attractive, but the investor keeps only the net, after the fee drag, and two funds with the same gross return can deliver very different net returns depending on their fees. The investor must therefore focus on the net return, not the gross, because the net is what builds its wealth.

The fee drag that separates gross from net is large, illustrated in Figure 1, the gross-to-net bridge, which shows how the management fee, the carry, the fund expenses and the transaction fees reduce a representative gross return to the net the LP keeps. The drag in the figure consumes a substantial share of the gross return, and over the life of a fund, with the fees compounding, it can consume a quarter to a third of the gross. The fee drag is therefore not a minor deduction but a major determinant of the net return, and an investor that ignores it overstates the return it will actually earn.

Figure 1. The Gross-to-Net Bridge: How Fees Reduce the LP Return



The fee drag is also the most controllable part of the net-return equation, because the investor cannot control the gross return its managers produce but can influence, through manager selection, negotiation, and the levers examined later, the fees it pays. This makes the fee drag the natural focus for an investor seeking to improve its net return: it is large, it is controllable, and managing it directly increases what the investor keeps. An investor that focuses on the controllable fee drag, rather than only on the gross return it cannot control, can materially improve its net return through the levers the framework describes.

Focusing on the net return also disciplines the investor manager and fund selection, because the investor that compares funds on their net returns, after their differing fees, selects differently from one that compares on gross. A fund with a slightly lower gross return but lower fees may deliver a higher net return than one with a higher gross return but higher fees, and an investor focused on the net selects accordingly. The focus on net returns therefore improves the selection as well as the negotiation, and it is the foundation of investing in alternatives well, which is why net-to-LP is the only number that matters.

3. Conceptual Foundations

The decomposition of net-to-LP returns rests on several conceptual foundations. The first is the distinction between gross and net, and the centrality of net to the investor. The gross return is what the investments produce; the net is what the investor keeps after the fee drag; and the investor wealth is built by the net, not the gross. The distinction is fundamental, and the investor must focus on the net, decomposing the fee drag that separates it from the gross, to understand and manage what it actually keeps.

The second foundation is the structure of private market fees, which comprise the management fee, charged on capital, the carried interest, charged on profits above a hurdle, the fund expenses, and various transaction and other fees. Each component reduces the net return differently, and understanding the structure is the prerequisite to decomposing the drag and managing it. The fee structure determines how the drag arises, and the investor that understands it can identify which components most reduce its net return and which it can most influence, which is the basis of managing the drag.

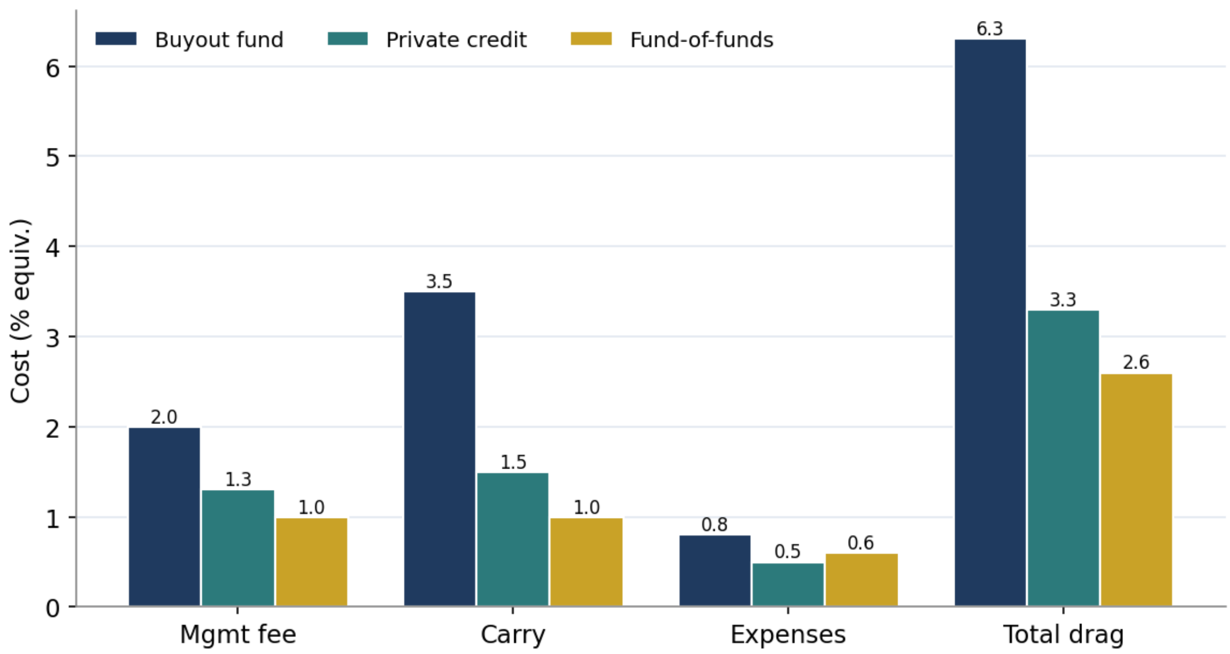
The third foundation is compounding, the way the fee drag accumulates over the life of an investment. Because the management fee is charged each year and the carry on the eventual profit, the drag compounds over the fund life, and a fee that seems modest annually accumulates to a large share of the gross over a decade, as Figure 3 in Section 6 shows. The compounding makes the fee drag larger over the fund life than its annual rate suggests, which is why the investor must consider the cumulative drag over the holding period, not just the annual fee, in assessing the true cost.

The fourth foundation is alignment, the way the fee structure aligns or misaligns the manager with the investor. The carried interest, charged on profits above a hurdle, aligns the manager with the investor return, rewarding the manager for delivering returns, while the management fee, charged regardless of performance, can misalign by rewarding asset gathering. The fee structure therefore embodies an alignment, and the investor should favour structures that align the manager with its return, through a meaningful hurdle and a carry that rewards genuine performance, which is part of managing the fee drag well, examined in Section 13.

4. The Anatomy of Private Market Fees

Private market fees comprise several components, illustrated in Figure 2, which compares the fee components across fund types. The management fee, typically charged annually on committed or invested capital, funds the manager operations and is charged regardless of performance. The carried interest, typically a share of the profits above a hurdle, rewards the manager for performance. The fund expenses, charged to the fund, cover its operating costs. And various transaction and other fees, charged on deals or to portfolio companies, can add further cost. Together these components form the fee drag.

Figure 2. Fee Components by Fund Type



The management fee is the most predictable component, charged annually at a rate, commonly around two percent, on committed or invested capital. Whether it is charged on committed or invested capital matters, because charging on committed capital, before it is invested, increases the effective fee, a point examined in the hidden costs section. The management fee compounds over the fund life, and over a decade it accumulates to a substantial share of the gross, even at a modest annual rate, which is why it is a major component of the drag.

The carried interest is the performance component, typically twenty percent of the profits above a hurdle, and it can be the largest component of the drag when the fund performs well, because it takes a share of the gains. The carry mechanics, the hurdle, the catch-up, and the waterfall, examined in Section 8, determine how much carry the manager actually earns, and they can make a material difference to the net return. The carry aligns the manager with performance, but it also takes a significant share of the gains, and understanding its mechanics is central to understanding the net return.

The fund expenses and transaction fees are the less visible components, often overlooked, that can add materially to the drag. The fund expenses, charged to the fund for its operations, and the transaction fees, charged on deals or to portfolio companies, can add a meaningful cost on top of the management fee and carry, and they are often less scrutinised by investors. These hidden costs, examined in Section 9, are part of the true fee drag, and an investor that examines only the headline management fee and carry, ignoring the expenses and transaction fees, understates the drag. The full anatomy of the fees, including the hidden components, is the basis of understanding the true cost.

5. The Gross-to-Net Bridge

The gross-to-net bridge, illustrated in Figure 1, is the central tool for decomposing the net return, showing how each fee component reduces the gross return to the net the LP keeps. The bridge begins with the gross return, deducts the management fee, the carry, the fund expenses, and the transaction fees in turn, and arrives at the net return. It makes the fee drag visible component by component, showing the investor exactly how much each component takes and how they together reduce the gross to the net.

The bridge is valuable because it makes the fee drag concrete and decomposed, rather than an abstract reduction, allowing the investor to see which components most reduce its net return and which it can most influence. An investor that builds the gross-to-net bridge for its funds can see the drag clearly, identify the largest components, and target its negotiation and its levers at the components that most reduce its net. The bridge is therefore the analytical foundation of managing the fee drag, making it visible and decomposed so the investor can manage it.

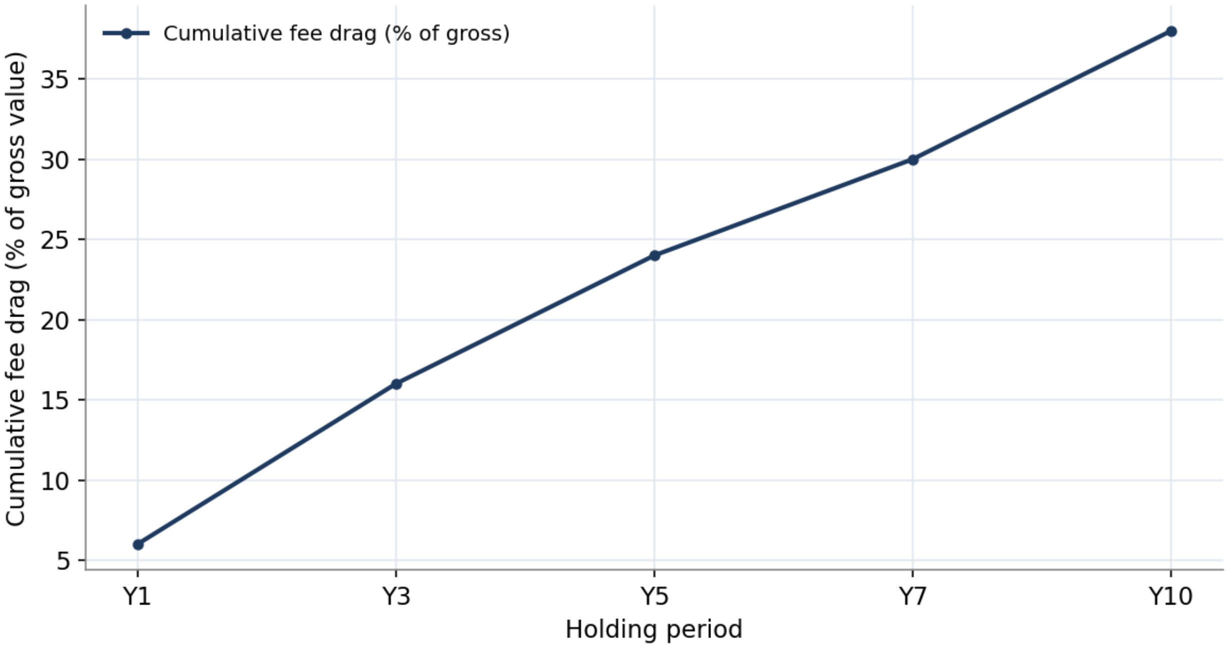
The bridge also allows the investor to compare funds on their net returns, after their differing fees, rather than their gross returns, which is the comparison that matters. By building the bridge for each fund, the investor can compare the net returns the funds would deliver after their fees, selecting the fund that delivers the higher net rather than the higher gross. The bridge therefore supports the net-focused selection examined in Section 2, allowing the investor to compare and select funds on the net return that matters, after the full fee drag the bridge decomposes.

Building the bridge requires the investor to obtain the full fee information, the management fee, the carry mechanics, the expenses, and the transaction fees, which managers do not always present transparently, and an investor must request and scrutinise the full fee information to build an accurate bridge. The transparency of the fee information varies across managers, and an investor should favour managers that present their fees transparently and should scrutinise the full fee terms of those that do not, to build the accurate bridge that reveals the true net return. The bridge is only as accurate as the fee information it is built on, which is why obtaining the full information is part of decomposing the net return.

6. How the Fee Drag Compounds

The fee drag compounds over the life of an investment, illustrated in Figure 3, which shows the cumulative drag rising over the holding period to consume a substantial share of the gross. Because the management fee is charged each year, it accumulates over the fund life, and because it is charged on capital that could otherwise be earning a return, it has an opportunity cost that compounds. Over a decade, the cumulative drag from the management fee alone can be substantial, and adding the carry and the other components, the total cumulative drag consumes a quarter to a third of the gross.

Figure 3. Cumulative Fee Drag Over the Holding Period



The compounding means the fee drag is larger over the fund life than its annual rate suggests, and an investor that considers only the annual fee rate understates the true cost. A two percent annual management fee sounds modest, but over a decade, with the compounding and the carry, the total drag is far larger, consuming a major share of the gross. The investor must therefore consider the cumulative drag over the holding period, not just the annual rate, to understand the true cost, which the compounding makes much larger than the annual rate alone would suggest.

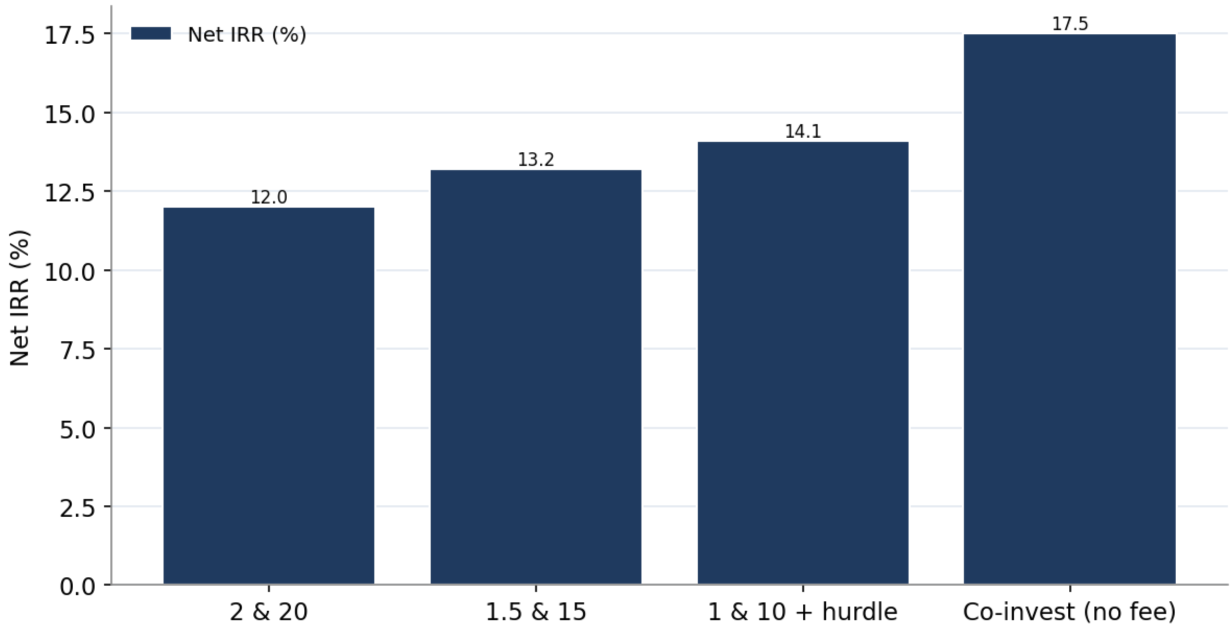
The compounding also means that small differences in the annual fee rate accumulate to large differences in the net return over the fund life, which is why negotiating the fee rate matters. A difference of half a percent in the annual management fee, or a few percent in the carry, accumulates over a decade to a meaningful difference in the net return, so the investor that negotiates a lower fee captures a meaningful net-return benefit over the fund life. The compounding therefore makes the fee negotiation more valuable than the annual difference suggests, because the difference compounds over the holding period.

The compounding is most consequential for the longest-held investments, where the drag accumulates over the most years, and least for the shortest-held, which is a consideration in the investor strategy. A long-held buyout or venture investment accumulates more drag than a shorter-held investment, so the fee drag is a larger consideration for the longer-held strategies, and the investor should weigh the cumulative drag in its strategy selection. The compounding therefore varies with the holding period, and it is a larger consideration for the longer-held strategies, which the investor should account for in its strategy and its fee management.

7. Fee Structures Compared

Fee structures vary, and the structure materially affects the net return, illustrated in Figure 4, which compares the net IRR under different fee structures for the same gross return. The traditional two-and-twenty, a two percent management fee and twenty percent carry, is the standard, but lower-fee structures, and structures with a meaningful hurdle, deliver a higher net return, and co-investment, with no fee, delivers the highest. The structure is a major determinant of the net return, and the investor should understand and, where possible, negotiate toward the more favourable structures.

Figure 4. Net IRR Under Different Fee Structures



The trend in fee structures has been away from the rigid two-and-twenty toward more varied and, for large investors, more favourable structures, as investors have pushed back on fees and as competition among managers has grown. Large investors can negotiate lower management fees, reduced carry, a meaningful hurdle, or fee offsets, and the structures have become more negotiable, particularly for the largest and most valued investors. The investor should understand the range of structures and negotiate toward the more favourable, recognising that the structure is negotiable, particularly for a valued investor.

The hurdle, the return the fund must exceed before the manager earns carry, is a particularly important structural feature, because a meaningful hurdle ensures the manager earns carry only on genuine outperformance, aligning it with the investor and reducing the carry drag on modest returns. A structure with a meaningful hurdle delivers a higher net return on modest gross returns than one without, because the manager earns no carry until the hurdle is exceeded, and the investor should favour structures with a meaningful hurdle. The hurdle is therefore a key structural feature, examined further in the carry mechanics, that the investor should seek.

Co-investment, examined in the companion paper, is the structure that delivers the highest net return, because it charges little or no fee, capturing almost the full gross return. The co-investment structure, with no management fee and no carry, delivers a net return close to the gross, materially above the fund net return, which is why co-investment is the most powerful lever on the net return, as the levers section discusses. The fee structure comparison therefore points to co-investment as the most favourable structure, and to the negotiation of lower fees and meaningful hurdles within the fund structures, as the ways to improve the net return.

8. The Carried-Interest Mechanics

The carried-interest mechanics, the hurdle, the catch-up, and the distribution waterfall, determine how much carry a manager actually earns, and they can materially affect the net return. The hurdle is the return the fund must exceed before the manager earns carry; the catch-up is a provision that lets the manager catch up to its full carry share once the hurdle is met; and the waterfall is the order in which the fund distributes capital, return, hurdle, catch-up, and carry. Understanding these mechanics is essential to understanding how much carry the manager earns and therefore the net return.

The hurdle and the catch-up interact to determine the carry on returns above the hurdle. A fund with a hurdle but a full catch-up earns, once the hurdle is exceeded, its full carry share on all the profits including those up to the hurdle, because the catch-up lets it catch up; a fund with a hurdle but no catch-up earns carry only on the profits above the hurdle. The catch-up therefore materially affects the carry, and an investor should understand whether a fund has a catch-up and how it works, because it determines how much carry the manager earns on returns above the hurdle.

The distribution waterfall also matters, particularly the distinction between a European, or whole-fund, waterfall and an American, or deal-by-deal, waterfall. A European waterfall returns all the investor capital and the hurdle before the manager earns any carry, while an American waterfall lets the manager earn carry on each profitable deal before all the capital is returned, which can advantage the manager and disadvantage the investor if later deals lose money. The investor should favour the European waterfall, which is more protective, and understand the waterfall a fund uses, because it affects the timing and amount of the carry and therefore the net return.

The carry mechanics, taken together, determine how much of the gross profit the manager takes as carry and how much reaches the investor as net, and they can vary materially between funds with the same headline carry rate. Two funds with a twenty percent carry can deliver very different net returns depending on their hurdle, catch-up, and waterfall, so the investor must understand the full carry mechanics, not just the headline rate, to understand the net return. The carry mechanics are therefore a key part of decomposing the net return, and an investor that understands them can assess the true carry drag and negotiate more favourable mechanics, such as a meaningful hurdle and a European waterfall.

9. The Hidden Costs

Beyond the headline management fee and carry lie the hidden costs, the fund expenses, the transaction fees, and the fees charged on committed rather than invested capital, that add materially to the drag and are often overlooked. The fund expenses, charged to the fund for its operations, legal, audit, administration, can be significant, and the transaction fees, charged on deals or to portfolio companies, can add further cost. These hidden costs are part of the true fee drag, and an investor that examines only the headline fees understates the true cost.

The fee charged on committed rather than invested capital is a particular hidden cost, because charging the management fee on the full committed capital, before it is invested, increases the effective fee on the invested capital. During the investment period, when much of the committed capital is not yet invested, charging the fee on the full commitment means the investor pays a fee on capital that is not yet working, which raises the effective fee. The investor should understand whether the fee is charged on committed or invested capital, and should favour funds that charge on invested capital, because charging on committed capital raises the effective drag.

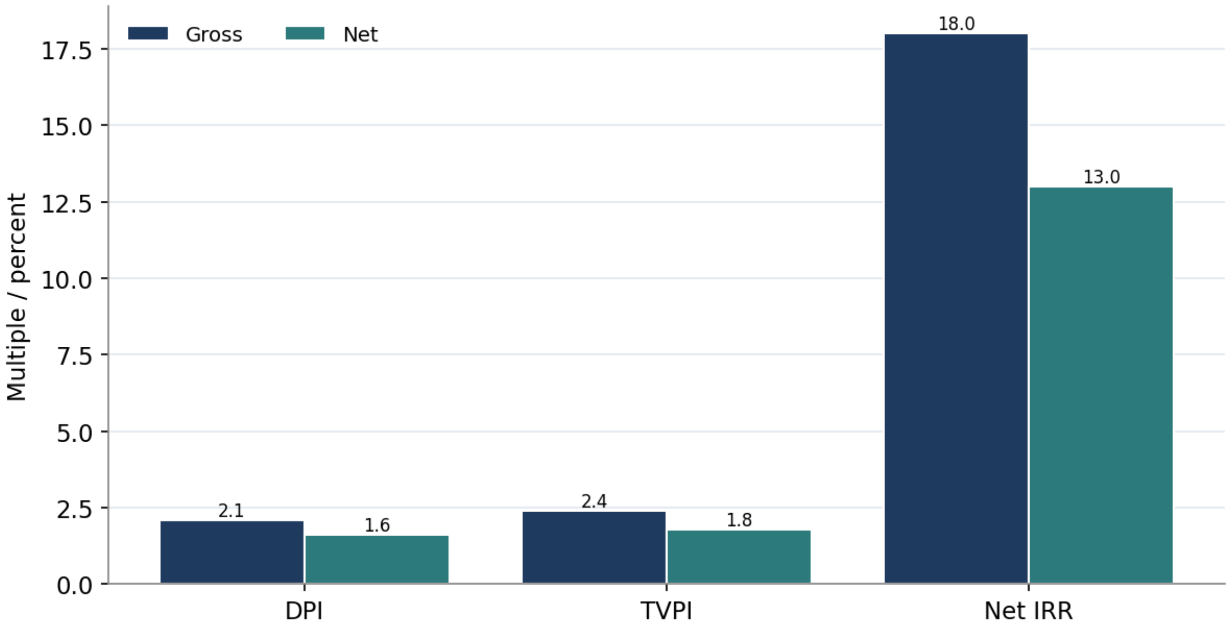
The transaction and monitoring fees that managers charge to portfolio companies are another hidden cost, because these fees, charged to the companies the fund owns, ultimately come out of the value that would otherwise accrue to the investor, unless they are offset against the management fee. The fee offset, the provision that offsets the transaction and monitoring fees against the management fee, returns these fees to the investor, and the investor should seek a full fee offset, because without it the transaction and monitoring fees are an additional drag. The fee offset is therefore an important term, and the investor should understand and negotiate it.

The hidden costs, taken together, can add materially to the headline fee drag, and an investor that examines only the headline management fee and carry can significantly understate the true cost. The fund expenses, the transaction fees, the committed-versus-invested basis, and the fee offset can together add a meaningful drag on top of the headline fees, and the investor must examine the full fee terms, including these hidden costs, to understand the true net return. The hidden costs are therefore a key part of decomposing the net return, and surfacing and managing them, through transparency and negotiation, is part of managing the true fee drag.

10. Measuring Net Returns

Measuring net returns correctly is essential to managing them, and several measures matter, illustrated in Figure 5, which compares gross and net on the key measures. The internal rate of return measures the time-weighted return; the multiple on invested capital, or MOIC, measures the total return as a multiple; the distributions to paid-in, or DPI, measures the realised cash returned; and the total value to paid-in, or TVPI, measures the total value including unrealised. Each measure should be examined net, after fees, because the net is what the investor keeps.

Figure 5. Gross versus Net on Key Return Measures



The distinction between realised and unrealised returns, captured by DPI versus TVPI, is important because the unrealised value is an estimate that may not be realised, while the realised cash, the DPI, is what the investor has actually received. An investor should weigh the DPI, the realised cash, alongside the TVPI, the total value including unrealised estimates, recognising that the unrealised value is uncertain. The DPI is the harder measure of what the investor has actually received, and an investor should not be dazzled by a high TVPI built on unrealised estimates that may not be realised, particularly net of the carry that would be charged on realisation.

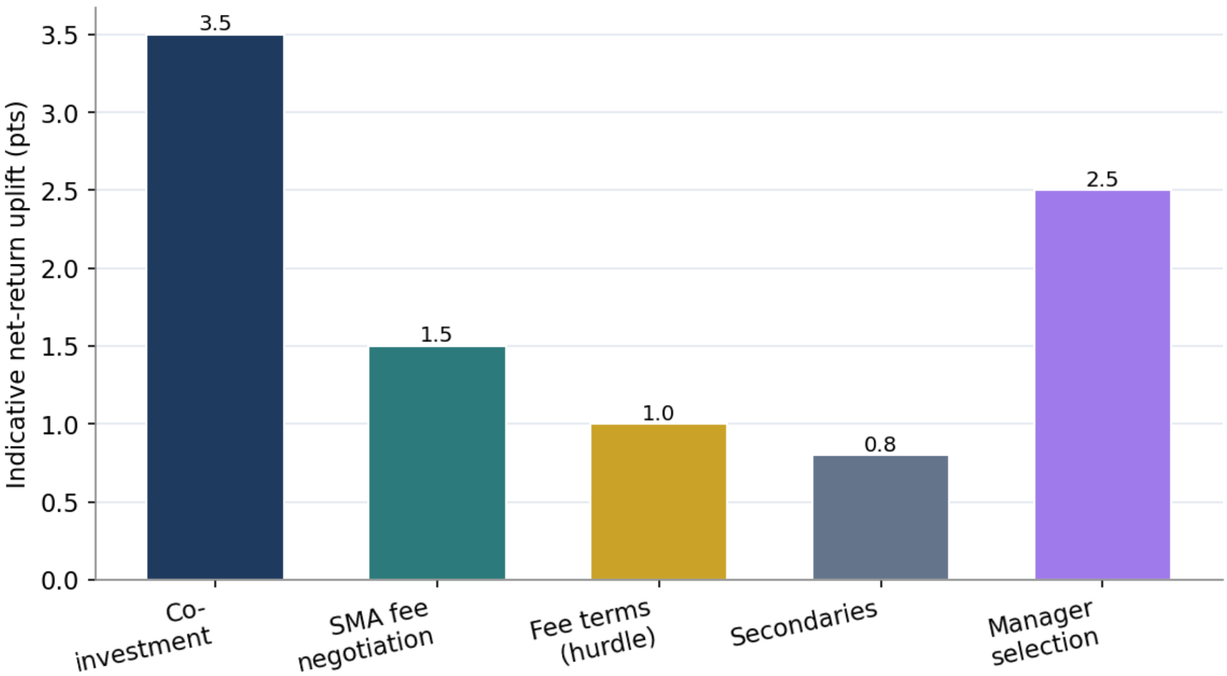
The public market equivalent, or PME, is a measure that compares the private market net return to what the investor would have earned in public markets, which is a useful test of whether the private market investment, after its fees, has outperformed the public alternative. An investor should examine the PME, because the private market net return is worth the illiquidity and the fees only if it exceeds the public alternative, and the PME tests this directly. The PME is therefore a valuable measure, testing whether the net return justifies the private market allocation, and an investor should use it to assess whether its private market investments, net of fees, are earning their keep.

Measuring the net returns correctly, on the right measures and net of all fees, is the basis of assessing and managing them, and an investor that measures its net returns rigorously, examining the IRR, the multiples, the DPI, the TVPI, and the PME, all net, understands what it is actually earning. An investor that relies on the gross headline measures, or on the TVPI built on unrealised estimates, may overstate what it is earning, while one that measures rigorously net knows the true return. The rigorous measurement of net returns is therefore the foundation of managing them, and it is part of the discipline of focusing on the net that the framework emphasises.

11. The Levers to Improve Net Returns

An investor has several levers to improve its net return by managing the fee drag, illustrated in Figure 6, which compares the net-return uplift from each lever. The most powerful is co-investment, which charges little or no fee and so captures almost the full gross return on the co-invested portion, as the companion paper examined. The others include negotiating lower fees through a separately managed account or as an anchor investor, securing favourable fee terms such as a meaningful hurdle, using the secondary market, and, above all, selecting managers whose net returns are high.

Figure 6. Net-Return Uplift by Lever



Co-investment is the most powerful lever, as Figure 6 shows and the companion paper examined, because it eliminates or sharply reduces the fee on the co-invested capital, capturing almost the full gross return. An investor that co-invests a substantial share of its allocation lifts its blended net return materially, which is why co-investment is the most sought-after right and the most powerful net-return lever. The investor should pursue co-investment as the primary lever on its net return, building the access and capability the companion paper described, because it delivers the largest uplift.

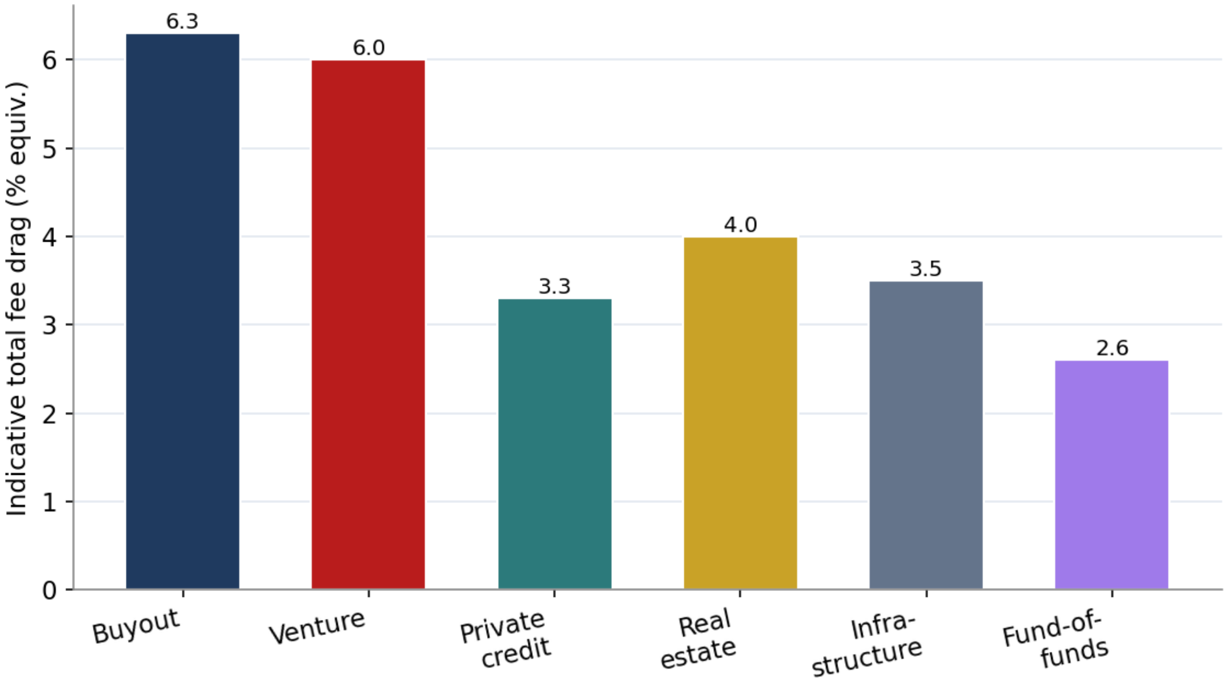
Negotiating the fee terms is the second lever, available particularly to large and valued investors, who can negotiate lower management fees, reduced carry, a meaningful hurdle, a full fee offset, and a fee charged on invested rather than committed capital. An investor with scale and standing can negotiate materially better terms than the standard, capturing a meaningful net-return uplift, and it should use its standing to negotiate. The negotiation is a powerful lever for large investors, and even smaller investors can negotiate at the margin, so the investor should always negotiate the fee terms rather than accepting the standard, because the terms are negotiable and the negotiation improves the net.

Manager selection is the lever that is easy to overlook but that most determines the net return over the long run, because the net return depends most on the manager performance, and selecting managers whose net returns are high, after their fees, is the foundation of a high net return. As the companion papers emphasised, the dispersion between the best and worst managers is wide, and selecting the best, on a net basis, most determines the net return. The investor should therefore select managers on their net returns, combining the manager selection lever with the fee-management levers, to maximise the net return it keeps, which is the combination the framework recommends.

12. Benchmarking Fees

Benchmarking fees, comparing the fees an investor pays against the market norms for the fund type, is part of managing the fee drag, because it tells the investor whether its fees are high, average, or low relative to the market, informing its negotiation. Figure 7 illustrates the indicative total fee drag by asset class, showing that the drag varies materially across fund types, highest for buyout and venture, lower for private credit and fund-of-funds. The investor should benchmark its fees against these norms, to know where its fees stand and where to negotiate.

Figure 7. Indicative Total Fee Drag by Asset Class



The variation in the fee drag across asset classes, shown in Figure 7, means the investor should benchmark its fees against the norms for the specific asset class, not against a single standard. Buyout and venture funds charge higher fees, reflecting their higher-touch, higher-return strategies, while private credit and fund-of-funds charge lower fees on their lower-return strategies, though fund-of-funds add a second layer. The investor should benchmark its fees against the norm for each asset class, recognising that the appropriate fee differs by asset class, and should negotiate toward or below the norm.

Benchmarking the fees informs the negotiation, telling the investor where its fees stand and giving it the market evidence to negotiate toward the norm or below. An investor that knows the market norms can negotiate from evidence, pushing back on fees above the norm and seeking terms at or below it, while one that does not know the norms negotiates blind. The benchmarking therefore arms the negotiation, and an investor should benchmark its fees as the basis for negotiating them, using the market norms as the reference point for what it should pay.

Benchmarking should consider the full fee drag, including the hidden costs, not just the headline management fee and carry, because the full drag is what matters and it varies across funds even at the same headline rate. An investor benchmarking only the headline fees may miss differences in the hidden costs that materially affect the net, while one benchmarking the full drag, including the expenses, transaction fees, and terms, compares the true cost. The benchmarking should therefore be of the full fee drag, the true net cost, which is the comparison that matters, and which informs the negotiation toward the best true net terms.

13. Manager Alignment and the Economics of Fees

Fees are not only a cost; they are a signalling device. The way a manager structures its economics tells a limited partner a great deal about where the manager expects to make money and how confident it is in the strategy. A manager that derives most of its income from management fees is, in effect, running an asset-gathering business in which scale matters more than performance. A manager that accepts a thin management fee and concentrates its upside in carried interest is signalling that it expects to earn through results. Neither model is wrong, but the alignment they produce is very different, and an investor should read the fee structure as a statement of intent rather than a simple price tag.

The asset-gathering trap. As a fund family grows, management fee income on committed capital can become large enough to fund a comfortable business regardless of performance. At that point the marginal incentive to take risk in pursuit of carry weakens, and the manager may drift toward preserving the franchise rather than maximising the return on any single fund. Investors should watch for managers whose fee income has outgrown the discipline of performance, because the gap between gross talent and net delivery tends to widen precisely when a manager no longer needs the carry.

Alignment is strengthened by three features that an investor can check directly. The first is a meaningful general partner commitment, ideally funded in cash rather than waived fees, so that the manager loses real money when the fund underperforms. The second is a hurdle rate that forces the manager to clear a genuine cost of capital before carry begins, rather than a token threshold. The third is a whole-fund, or European, distribution waterfall that defers carry until investors have received their capital and preferred return across the entire portfolio, rather than allowing the manager to collect carry on early winners while later losses are still unrealised.

14. The GCC and UK Investor Lens

For investors based in the Gulf and the United Kingdom, the net-to-LP question carries additional layers that a generic analysis tends to miss. Currency, tax treatment, the choice of fund domicile and the availability of Shariah-compliant structures all interact with headline fees to determine the return that actually reaches the beneficiary. A family office in the UAE measuring outcomes in dirhams, which are pegged to the dollar, faces a different translation risk from a UK institution reporting in sterling, and the cost of hedging that exposure is a real and often overlooked component of the net result.

Domicile, withholding and the leakage that fees obscure

Fund domicile determines the withholding tax applied to underlying income and the treaty relief an investor can claim. A Gulf family office investing through a vehicle in a jurisdiction with a weak treaty network may suffer withholding leakage that dwarfs a ten basis point negotiation on management fee. The disciplined approach is to model the full chain, from the underlying asset through the fund vehicle to the investor, and to treat tax leakage as part of the cost of the strategy rather than a separate administrative matter.

For investors who require Shariah compliance, the structuring choice interacts with cost in a further way. Compliant vehicles often carry additional layers of administration, board supervision and purification, each of which has a price. These costs are legitimate, but they should be quantified and compared against the value of compliance rather than absorbed silently, so that the investor knows what compliance is costing in net-return terms and can decide whether the trade is acceptable.

15. The General Partner Perspective

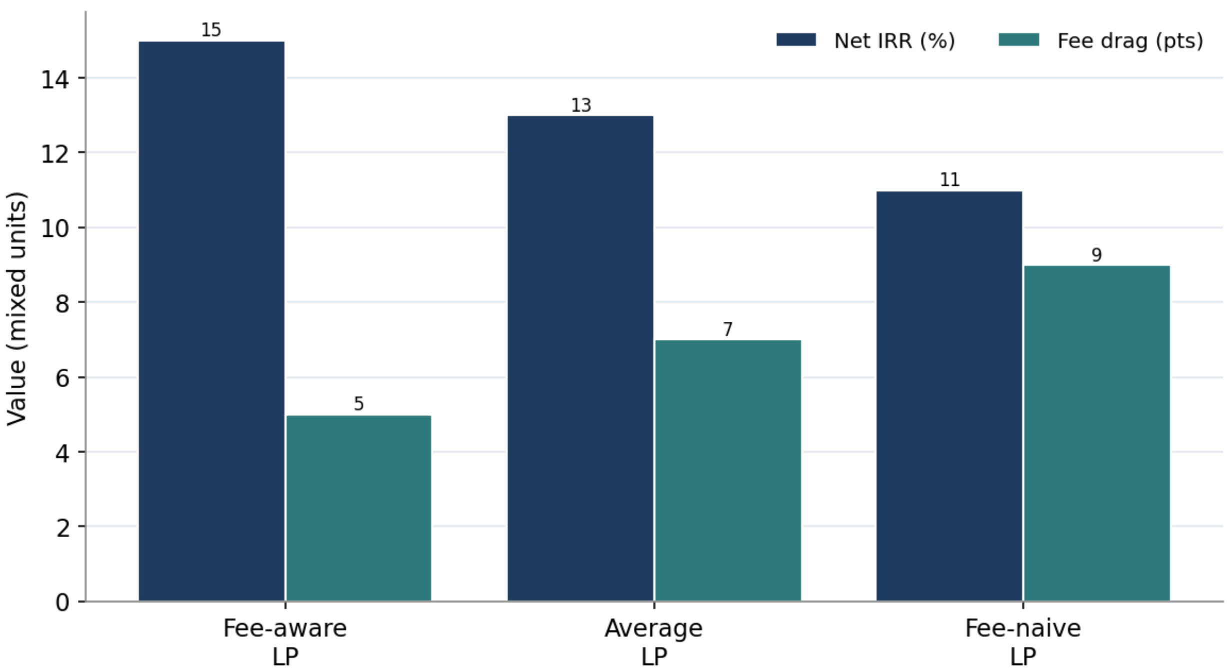
A balanced analysis acknowledges that the manager faces real and rising costs. Talented investment professionals are expensive and mobile. Regulation, cyber security, valuation governance and investor reporting have all grown more demanding, and the operating cost of running an institutional-quality firm has climbed accordingly. A management fee that looks generous in the abstract may, for a mid-sized manager early in its life, barely cover the cost of building a durable team and the systems that investors now expect.

The constructive conclusion is not that fees should be as low as possible, but that they should be fair in relation to the value created and transparent enough that an investor can judge them. A manager that can articulate where its costs sit, why its fee is set where it is and how its incentives are aligned with the investor will, over time, attract more patient and loyal capital than one that competes purely on a low headline number while recovering margin through opaque charges. Sustainable economics on both sides are a precondition for the long-term relationships that private markets depend on.

16. Three Worked Cases

The following cases trace the same gross outcome through three different fee architectures to show how the structure, rather than the underlying performance, shapes what the investor finally keeps. Each fund is assumed to deliver an identical gross multiple on a five-year hold; the only variable is how the economics are shared.

Figure 8. Net-to-LP Outcomes Under Three Fee Architectures



Same gross performance; outcomes differ only by fee structure.

Table 1. Case Comparison: Identical Gross, Different Net

Case	Structure	Gross MOIC	Total fee load	Net-to-LP MOIC
A	2 and 20, deal-by-deal carry	2.20x	**~0.42x**	1.78x
B	1.5 and 15, whole-fund carry, 8% hurdle	2.20x	**~0.31x**	1.89x
C	1 and 10, whole-fund, 8% hurdle, fee offset	2.20x	**~0.23x**	1.97x

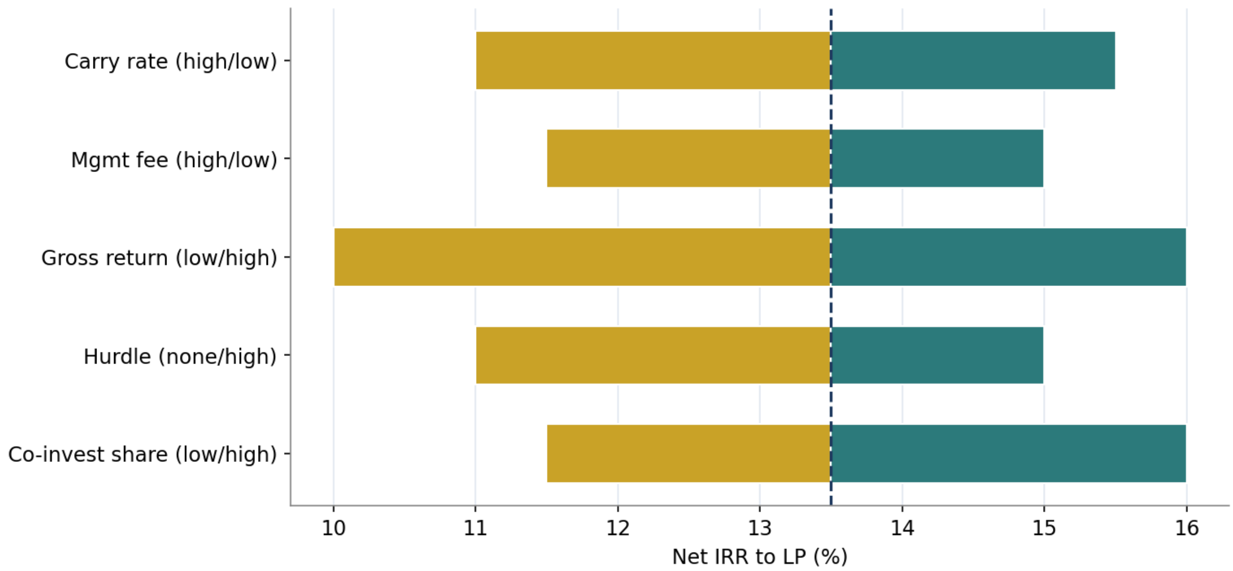
MOIC is multiple on invested capital. Fee load is the cumulative drag expressed as a reduction in MOIC.

Reading the cases. The nineteen basis points of MOIC that separate Case A from Case C do not come from better investing. They come entirely from structure: a lower management fee, a whole-fund waterfall that defers carry until the investor is made whole, a genuine hurdle and the offset of transaction fees against the management fee. An investor who treats these terms as negotiable, rather than as fixed features of the market, can capture a material part of that difference without taking a single unit of additional risk.

17. Sensitivity Analysis

Net-to-LP outcomes are most sensitive to the variables that compound over the life of the fund. To show which terms matter most, the analysis varies each input around a base case while holding the others constant, and records the effect on net multiple. The result is the familiar tornado shape, with the widest bars marking the terms that deserve the most attention in negotiation.

Figure 9. Sensitivity of Net-to-LP Multiple to Key Terms



Each bar shows the swing in net multiple from varying one term around the base case.

The ordering is instructive. The hold period and the management fee dominate, because both act on the entire capital base for the entire life of the fund. The carry rate matters less than many investors assume, because it applies only to profit above the hurdle and only once. The hurdle rate and the choice between deal-by-deal and whole-fund carry sit in the middle, important but secondary to the steady drag of the annual fee. The practical lesson is that an investor pressing for a lower management fee and a shorter, more disciplined hold is working on the levers that move the result most.

18. International Comparison

Fee norms vary across markets and asset classes in ways that reward an investor who shops with a clear frame of reference. Large-cap buyout in North America still anchors near the traditional two and twenty, though scale buyers routinely negotiate below it. European mid-market managers often carry slightly lower management fees but firmer hurdles. Private credit has compressed toward a one to one and a half management fee with a ten to fifteen carry, reflecting the more contractual nature of its returns. Venture retains higher carry in the strongest franchises, where access rather than price is the binding constraint.

Table 2. Indicative Fee Norms by Strategy

Strategy	Management fee	Carry	Hurdle	Typical waterfall
Large buyout	1.5 to 2.0%	20%	8%	Whole-fund
Mid-market buyout	1.5 to 2.0%	20%	8%	Whole-fund
Private credit	1.0 to 1.5%	10 to 15%	5 to 7%	Whole-fund
Venture capital	2.0 to 2.5%	20 to 30%	None to 8%	Deal-by-deal common
Real estate	1.0 to 1.5%	15 to 20%	8 to 9%	Whole-fund

Ranges reflect common institutional terms; individual funds vary with size, track record and bargaining power.

19. Net Returns in Portfolio Construction

Fees should enter the portfolio decision at the point of allocation, not as an afterthought at reporting time. Two managers with the same gross expectation but different fee loads are, in net terms, different assets, and they should be modelled as such when an investor builds expected returns for the overall portfolio. Failing to net fees before the allocation decision inflates the expected return of the whole book and leads to systematic over-allocation to high-fee strategies that look attractive only on a gross basis.

The discipline extends to rebalancing. Because fee drag compounds, a small net disadvantage in one sleeve grows over a multi-year horizon into a meaningful gap in terminal wealth. An investor who reviews net-of-fee performance against a net benchmark, and who is willing to redeploy from persistently expensive managers into cheaper structures of comparable quality, captures a return that requires no market view at all. It is, in the truest sense, return earned through cost control rather than risk.

20. Common Errors

- **Confusing gross with net.** comparing gross returns across managers without netting fees, which flatters the most expensive structures.

- **Accepting terms as given.** treating the headline two and twenty as fixed, when management fee, hurdle, waterfall and fee offsets are all negotiable for committed capital of reasonable size.
- **Negotiating the wrong lever.** focusing on the carry rate while ignoring the management fee, even though the fee usually drives the larger share of total drag.
- **Ignoring hidden costs.** overlooking transaction, monitoring and administrative charges that sit outside the headline and can add materially to the total load.
- **Weak clawback protection.** permitting deal-by-deal carry without a robust clawback, which lets a manager keep carry on early winners while later losses erode the fund.

21. An Implementation Roadmap

A practical programme for improving net-to-LP outcomes can be sequenced over a single allocation cycle. The aim is to move from accepting headline terms toward a disciplined process that treats cost as a managed variable.

1. Build a net-return model for every prospective commitment that runs the full gross-to-net bridge, including management fee, carry, hurdle, fund expenses and expected tax leakage.
2. Benchmark each manager's proposed terms against the relevant strategy norms in Table 2, and identify the two or three terms where the gap is widest.
3. Negotiate the high-impact levers first, led by management fee and waterfall structure, using the sensitivity ordering rather than instinct to set priorities.
4. Insist on a most-favoured-nation clause so that any better terms granted to other investors flow through, and require transparent reporting of all charges outside the headline fee.
5. Review net-of-fee performance annually against a net benchmark, and redeploy from persistently expensive managers into comparable cheaper structures.

22. A Strategic Perspective

The investors who compound capital most effectively in private markets are rarely those who chase the highest gross returns. They are the ones who treat cost as a controllable source of return, who understand that a structure deferring carry and charging a fair fee can beat a more expensive fund with better headline performance, and who bring the same rigour to the terms of a commitment that they bring to the underwriting of the underlying assets. Net-to-LP discipline is, in the end, a form of humility: an acknowledgement that the part of the return an investor can most reliably control is the part they agree to give away.

23. Conclusion

Gross return is what a manager produces. Net-to-LP is what an investor keeps, and only the second pays for retirements, endowments and family obligations. The gap between the two is neither random nor immovable. It is the predictable result of fee structures that can be read, modelled and negotiated. An investor who internalises the gross-to-net bridge, who knows which terms move the result most and who is willing to press on them, will over a full cycle retain materially more of every dollar of gross performance than one who accepts the headline and hopes for the best. That retained margin, compounded across a portfolio and a career, is among the most durable advantages available in private markets.

24. Limitations

This paper uses modelled figures to illustrate mechanics and relationships rather than to forecast the outcome of any specific fund. Real funds vary in strategy, vintage, leverage and tax position, and the interaction of these factors with fees is more complex than any single model can capture. The fee norms cited are indicative of common institutional practice and should be checked against current market conditions and the specific terms on offer. Nothing here constitutes investment, tax or legal advice, and investors should obtain advice tailored to their own circumstances before acting.

Appendix A. Base Case Assumptions

Table 3. Base Case Parameters Used in the Models

Parameter	Base case value
Gross MOIC	2.20x
Hold period	5 years
Management fee	1.75% on committed, then invested
Carried interest	20%
Hurdle rate	8% preferred return
Waterfall	Whole-fund (European)
Fund-level expenses	0.25% per annum
Fee offset	100% of transaction fees

Base case parameters held constant in the sensitivity analysis except for the term being varied.

Appendix B. A Net-to-LP Diligence Checklist

- Has the full gross-to-net bridge been modelled, including fund expenses and tax leakage?
- Is the management fee charged on committed or invested capital, and how does it step down after the investment period?
- Is the waterfall whole-fund or deal-by-deal, and is the clawback robust and personally guaranteed?
- Is there a genuine hurdle, and does a catch-up apply once it is cleared?
- What share of transaction and monitoring fees is offset against the management fee?
- Is there a most-favoured-nation clause covering terms granted to other investors?
- How are charges outside the headline fee reported, and how often?

Appendix C. Glossary

Carried interest. The manager's share of fund profits, typically paid only above a hurdle.

Catch-up. A waterfall feature letting the manager collect a larger share of profit immediately above the hurdle until its overall carry share is restored.

Clawback. An obligation on the manager to return excess carry if later losses mean it was overpaid.

DPI. Distributions to paid-in capital; cash actually returned relative to cash invested.

Hurdle rate. The preferred return an investor must receive before the manager earns carry.

MOIC. Multiple on invested capital; total value divided by capital invested.

Net-to-LP. The return an investor keeps after all fees, carry and expenses.

Waterfall. The order in which fund cash flows are distributed between investors and manager.

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About the Author

Chennakeshav Adya is an independent researcher and transaction advisor with more than two decades of experience across strategy, corporate finance and private markets, spanning the United Arab Emirates, the United Kingdom, India and beyond. He writes on alternative investments, fund economics and capital structuring for institutional and family-office investors, and is a guest speaker at London Business School. His work focuses on translating practitioner experience into rigorous, accessible frameworks for allocators in the Gulf and the United Kingdom.