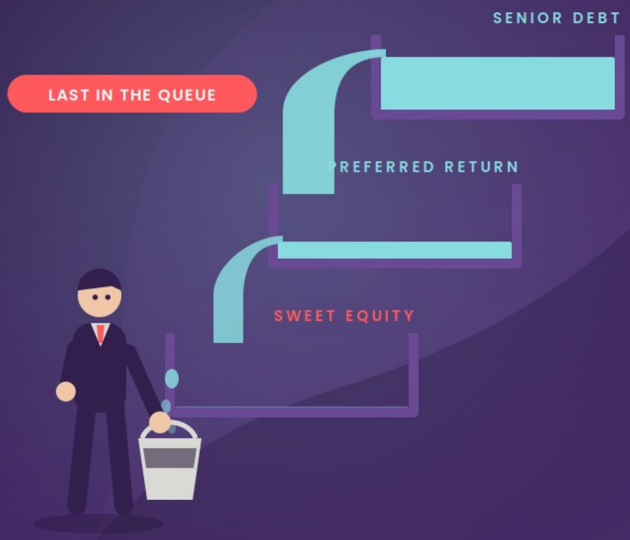
REWARD & INCENTIVE STRUCTURES

When the Ratchet Doesn’t Pay Out

Stephen Rayment · Founder, CEO & Group Managing Director, Systech MDP



A perspective from Systech International

Most senior people who join a PE-backed platform do so on the promise of a specific trade: give up some certainty now, in exchange for a large payout when the fund exits. That trade only works one way. It depends entirely on the fund hitting its return target: typically a 20%+ IRR over a five-to-seven-year hold. Miss it, and the mechanics built to reward you can just as easily leave you with very little.

We think a growing number of talented rainmakers are running into that exact problem right now. This is a look at why, and at what an independent, privately owned model like Systech’s offers as an alternative.

HOW THE UPSIDE DISAPPEARS

The packages built around PE ownership are deliberately asymmetric. A few mechanisms explain why a missed target hits pay so hard:

- **Subordinated sweet equity.** Senior managers are typically given cheap ordinary shares, but those shares sit at the very bottom of the exit waterfall. On a sale, proceeds pay off the bank debt first, then repay the fund’s preferred return (its capital plus an accruing coupon), and only what is left over reaches management. In a weak exit there is often little or nothing left once debt and the preferred return are cleared, so the sweet equity can be worth close to zero. What erodes the payout is this subordination, being last in the queue, tied to the fund’s overall return rather than to how well the underlying business, or the individual, actually performed. A separate ratchet mechanism runs the other way, lifting management’s share once the fund clears its hurdles, rewarding the upside but offering no protection when the exit falls short.
- **Cash bonus targets tied to fund-level metrics.** Annual incentives are frequently linked to EBITDA growth or exit multiples the individual has limited control over, rather than the client relationships and fee income they personally generated.
- **Clawbacks.** Some agreements allow bonuses already paid to be recovered if performance deteriorates or the eventual exit falls well short of the original underwriting case.

- **Extended holds and forced leaver events.** When targets are missed, funds often hold longer than planned rather than crystallise a loss, leaving management's equity illiquid and vulnerable to further dilution, or exposed to "bad leaver" provisions if the fund decides to change the team.

None of this is hidden in the fine print. **It's the whole design.** The upside is real when the fund's numbers work. When they don't, the same structure that promised a big payday can leave rainmakers with a smaller one than a straightforward salary and bonus model would have delivered.

THE DESIGN

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THE MARKET BACKDROP MAKES THIS MORE LIKELY, NOT LESS

This isn't a one-off risk. Average private equity management fees hit a record low in 2025 as fundraising conditions tightened, and a large backlog of unrealised 2020–2021 vintage buyouts has left many funds struggling to exit assets at the valuations their models assumed. Higher rates have raised the cost of capital, making it harder to monetise portfolio companies at a profit: exactly the conditions in which hurdle rates get missed and ratchets fail to pay out.

At the same time, private equity has moved deeper into professional services, including law firms and claims consultancies, through management services organisation and alternative business structures. More senior people in our sector than ever before are now sitting inside a PE return model, which means more of them are exposed to what happens when that model underdelivers.

A DIFFERENT DEAL

Systech is privately owned and financed. There's no fund-level hurdle sitting between an individual's effort and their reward, and no five-to-seven-year clock forcing an exit event that has nothing to do with how the business, or the individual, is actually performing.

That means:

- **Reward tied to what you actually generate** (client relationships, fee income, and the quality of work delivered), not a fund's blended portfolio return.
- **No subordinated equity that can zero out.** Performance-related reward reflects the business's real, ongoing profitability, not a hurdle rate calculated against someone else's cost of capital.
- **A longer time horizon.** Without an exit deadline dictating the calendar, decisions about clients, investment and people get made for the long term, not for the numbers a sale process needs to show.
- **Independence that matches the work.** For anyone practising in legal services or expert witness work, that independence isn't just a reward-structure benefit. It's the same principle our professional and tribunal duties already require of us.

THE QUESTION WORTH ASKING

If your reward depends on a fund achieving a return you can't control, on a timetable you didn't set, it's worth asking what happens to your pay if it doesn't land. **For a growing number of experienced rainmakers, the answer they're finding isn't reassuring, and it's why an independent model built around what you actually deliver is getting a second look.**

We're always glad to have that conversation.

Systech International is an independent, privately owned consultancy providing claims, dispute resolution, commercial management, legal and expert witness services.