PRIVATE EQUITY international

Ground Floor
Newspaper House
8-16 Great New Street
London EC4A 3BN
Tel: +44 (0)20 7906 1188
Fax: +44 (0)20 7583 8485

Placement power

It's a truism that raising a private equity fund is much harder than it used to be for many firms – although a much smaller group of "halo funds" are now succeeding in attracting more commitments than they themselves had planned. And evermore embedded in the fundraising process is the placement agent. Here's why.

Although it may have been tempting in the past for both limited and general partners to regard the placement agent as a match-maker only grudgingly accepted as part of the fundraising process, both sides are now much more attuned to how an agent can provide value. In particular, investors who are looking to commit capital to the asset class are using placement agents to help sift the various fund offerings available at present. Says one major institutional investor who has a significant allocation to private equity to deploy: "Although there are fewer funds being raised at the moment, the challenge now is to uncover those with the most potential. It's become a more opaque market. Established firms may well have lost key people or lack that hunger newer firms still have – whilst new firms need to evidence meaningful strategies as well as credible team track records. We look to a placement agent to help evidence all of this."

Placement agents have always had a curious duality about their role: the private equity firms raising a fund compensate them, but their ongoing success is dependent upon investors continuing to buy into the funds they represent – and that means providing objective coverage of these client funds. As one managing director at a placement agent comments: "No investor is going to thank us for selling them a fund that fails to deliver – and that can shut off a key prospect for our future client funds. We need to deliver as clear a picture as possible of a fund's strengths and weaknesses [to an investor]."

Nourishing relationships

These are interesting times for private equity fundraising. Many private equity firms' track records have lost some of their lustre, most commonly thanks to the implosion of the internet and telecommunications sectors. The paucity of exits has impacted on IRRs and has also reminded many that investing in a private equity fund is a long-term game. And institutional investors themselves are struggling with distorted allocation models that have left them over-exposed to private equity, at a time when their public equity holdings have slumped in value. But at the same time these investors are trying to reconcile depressed public equity returns with the need to deliver at least adequate performance to their own clients, making the opportunity to access superior returns via an allocation to alternatives all the more appealing.

These dynamics help explain why some well-established private equity groups are having to travel a long road to raise their funds (most notably the high profile buyout groups who had been hoping to raise billions of Euros) whilst other firms – both old and new – are successfully raising more than they originally targeted in less time. Arsenal Capital's US mid-market fund, Foreign & Colonial spin-out Graphite Capital's UK equivalent and brand new firm Altor Capital's inaugural (and again mid-market) fund are all evidence of this latter point. Besides the message that more narrowly focussed funds – and mid-market ones in particular - are proving popular, the fact that placement agents were involved in all three of these funds is telling: London-based Campbell Lutyens and Farrell Marsh worked on Arsenal, while Helix Associates represented both Graphite and Altor (which they shared with US placement group Monument).

Investors in private equity funds are especially cautious at present. For instance, one LP in the Graphite fund started talking to the firm over 12 months prior to making a commitment. Again, this is influencing how placement agents are contributing to the fundraising process. "Conversations are longer and more wide-ranging. Numbers change over time and have to be explained. The GPs get caught up in deals so can't manage the dialogue with prospects," explains one placement agent. "These are all reasons why we are having to nourish the relationship between the firm and investors."

It's also the case that placement agents are themselves developing what one called "greater LP-mindset skills." The depth and duration of the dialogue with investors is >>

such now that it makes considerable sense to be able to readily walk-the-walk and talk-the-talk with buyside institutions. And a very good way to do that is to hire a former investor. Recent hires by the grand-daddy of private equity placement Merrill Lynch, who took on Christian Dummett, Abbey National Treasury Services' former private equity portfolio manager, and at growing placement firm MVision who hired Paula Chester, the former head of alternatives at the New York State Comptroller's office to run their freshly-opened New York office, are both good examples of this.

> "GPs get caught up in deals so can't manage the dialogue with prospects"

Understanding the buyside is also no easy task at present. The increasing significance of private equity in many investors' portfolios, besides the challenge of selecting the right funds at the moment means that more thought and more scrutiny is being expended by investors on prospective funds and it often falls to the placement agent to manage the flow of questions and answers between the two sides – and to interpret the often nuanced points that an investor will table. "The due diligence process has become much more protracted," comments Niall Carroll, managing director of Irish venture investor ACT Venture Capital, who recently completed an ultimately successful fundraising campaign. "And our placement agent had the task of responding to the many and various requests we received from investors. I think everyone benefited from having this process traffic-controlled like this."

Survey: The impact of placement agents in the fundraising process

In order to get a better sense of how investors regard placement agents and the contribution they make to private equity fund raising at present, Private Equity International partnered with US website PrivateEquityCentral.Net and GP advisory firm Broadgate Consultants to poll over 120 limited partners about their views on placement agents*. These investors came from across Europe and the US and were all actively investing in private equity. The findings include evidence that placement agents already represent a sizeable portion of private equity funds that attract investment. It also confirmed that not all placement agents are the same.

One question we asked was how many of the private equity funds that each had invested in during the past two years had been represented by placement agents. 49 per cent said that less than half the funds they had put money into had used agents – suggesting that a significant number of private equity firms still successfully raised new capital without an agent. Another 35 per cent of respondents said that between half and three quarters of the funds they committed to had been represented by an agent. The remaining 16 per cent reported that at least three quarters of the funds they bought were represented by placement agents.

We also asked investors whether they would take a meeting from a general partner they were not familiar with but who had a distinctive investment proposition even if a placement agent did not represent that firm. Over 82 per cent of respondents said they would agree to a meeting – a figure high enough to be contrasted with the aforementioned result that saw a significant percentage of investors actually buying the majority of their private equity product from funds using placement agents. A reasonable inference here would be that there is an important gap between what it takes to present a fund and what it takes to secure commitments – and that the input of a placement agent helps close this.

Investors clearly discriminate when it comes to which placement agents they listen to as well. Respondents were first asked to comment about the competence of placement agents. Although a little more than half (58.5 per cent) said that the quality of service and level of professionalism of placement agents currently active had not changed significantly in the past three years, nearly a third (31.7 per cent) felt it was higher than three years ago – whilst less than 10 per cent thought it was actually lower. And more tellingly still, our investors felt there were marked differences in the level of professionalism and quality of service provided by different placement agents: over 71 per cent of respondents declared this can "differ significantly" between different firms and a further 22 pent felt it could "differ somewhat." Only seven per cent felt that these factors would be more or less the same between firms.

A final survey result is worth referencing as it confirms how LPs are deriving value from the input of placement agents: when asked to rank what they valued most it was the competence of the due diligence materials the agent produces that topped the tables, with the effectiveness of the agent's contact and follow up coming second and the track record of other funds the agent has represented coming third. It is this provision of substantive analysis of candidate funds that is encouraging investors to look more closely – and with good dialogue management by the agent subsequently – to commit to these funds.

** The complete survey is part of the forthcoming Market Report on Placement Agents published by the Private Equity Research Institute. More details about this report can be obtained from Private Equity International: email Pauline Richards at Pauline.r@investoraccess.com*