Choosing a placement agent

Life is difficult enough for private equity and venture capital firms looking to fund raise, but changes at the banks and boutiques that place those funds could complicate things before the fund raising process has even started. The fund placing business is evolving. Some players are expanding their services or forming new alliances, others have dropped out of the market and new ones are springing up in unexpected places. For general partners, the choice has never been so diverse. *Louise Cowley* reports.

Fewer private equity firms are braving the fund raising market today but of those that choose to, more are using a placement agent. Private equity funds raised in Europe peaked at €48bn in 2000 and the boom led to a dramatic increase in the number of groups offering fund placement services. New entrants and changes among the established players mean choosing the right placement agent is more difficult than ever.

General partners, unless they've had a bad experience, tend to stick with the placement agent they've used in the past. But because of recent changes among the players there's a good chance that some firms are reconsidering their choice. Unpredictable fund raising conditions mean even big name investors with long track records, who haven't used a placement agent in the past (except in specific instances such as the need or desire to expand the fund's investor base into new geographies), are now seeking their services. It looks like this class of intermediary is here to stay but how do GPs choose the placement agent that's right for them?

In a process that tends to be less formal than a beauty parade GPs rely on word of mouth, their competitors' experiences and references from LPs for recommendations. The choice between the placing services offered by the investment banks and those offered by independent boutiques is still a natural one for some firms but it's not as clear-cut as it once was. Buyout funds have a symbiotic relationship with investment banks. Banks have traditionally favoured large funds that bring lucrative M&A and audit work and the size suits the scale of a bank's operations while VC funds may be too small to be of interest.

One placement agent says: "Boutiques are fully focused on a handful of carefully selected GP relationships unlike banks which have a large pipeline of mandates and are in the business for strategic reasons. Private equity firms expect a very fruitful 'post placement' relationship with a bank." Buyout funds are no longer the exclusive preserve of the banks; boutiques are moving up a gear and plenty can now raise a couple of billion. Bernd Seibel, general partner and CFO of TVM's European operations, says: "In the future I think banks will still be there but not as big as they have been, their influence will go down."

The international reach of a bank and the sheer size of the organisation will always appeal to GPs looking to tap into a worldwide investor network. The question asked of boutiques is if they have these global contacts and it is often where smaller boutiques drop out of the race. "Boutiques have strengths but they're smaller so they also have limitations, there's more need to have [a placement agent] in Europe and one for the US," says Seibel. It's a more complicated option but some GPs prefer to use multiple placement agents covering different markets. For a boutique the moment it is represented on both sides of the Atlantic is undoubtedly a turning point.

"Banks have the widest distribution to a number of clients but boutiques tend to be more targeted in who they approach," says Dirk Kanngiesser, managing partner of German venture capital firm PolyTechnos. In this and other ways boutiques offer a different, advisory service to banks. GPs that use them feel the interests of the team at a boutique is often better aligned to those of the fund but small operations have to be careful how much they take on.

A GP's choice of placement agents also depends on who's free, as most boutiques only raise a handful of funds a year and turn away many funds. GPs want to be sure of having the placement agent's full attention and anyone raising a competing product is automatically ruled out. The rejection cuts both ways, however, because no placement agent worth its salt wants to deal with that sort of conflict of interest.

What are the issues?

Key issues differ from firm to firm but all agree that the personal relationship between a GP and their placement agent is influential. Partners spend a lot of time with their placement agents and increasingly it's a relationship that's maintained between fund raisings. It's not necessarily a deal-breaking issue if the teams don't get on but it certainly helps if the chemistry works.

Whether the agent is a bank or a boutique certain individuals are going to have influenced the decision to use that placement agent and if the main contact moves on the relationship falls into question. "LPs demand a key man clause in funds they invest in, should GPs expect the same from their placement agent?," asks Ian Simpson at Helix Associates. For the most part it's the banks this sort of clause would worry since those teams are traditionally less stable and recent personnel changes mean it's likely existing mandates will be challenged.

In a difficult market there is an increased requirement for VCs to distinguish themselves with a unique selling proposition and market a fund effectively. "Boutiques find and communicate market position better than banks," says Kanngiesser at PolyTechnos, which used MVision as the placement agent for its most recent fund. Graphite Capital used Helix Associates to raise its last two funds. Stephen Cavell, a partner at Graphite Capital, says: "They provided advice on packaging and presenting the fund, they helped us to differentiate ourselves from our peer group."

Part of the marketing process is making sure the right people see the PPM in the first place. A biotech fund is going to be of little interest to an LP who feels early stage venture capital is too high risk. It's equally important to the GP that the fund, which represents a ten-year relationship between GP and LP, comprises the right type of investors. Placing a fund is not just about the number of contacts a placement agent has but the qualities of those institutions and their expectations. "It's not an issue for [the placement agent] to have specific VC experience, it's more important to understand which investors are looking for venture rather than buyout funds," says Kanngiesser.

Some placement agents have developed expertise in particular sectors of the private equity industry but most retain a generalist approach and banks like to cover most aspects of the market. GPs might prefer a placement agent with some experience of raising a comparable fund but they are equally likely to avoid a group that has taken too many similar mandates. Seibel says: "It's very important to see experience but at the same time the team must also still be hungry." Investors want diverse portfolios and wouldn't expect a placement agent to bring them several funds in the same market niche. For their part, placement agents will avoid over-specialisation to spread their own risk.

GPs value the knowledge a placement agent builds during a fund raising and many continue the relationship during the life of the fund by offering complementary services such as investor relations support. "MVision has helped review our quarterly reporting process, given advice on how to structure, and add information and we've discussed the idea of ad hoc reporting," says Kanngiesser. Seibel says UBS Warburg's placement team provides TVM with a market overview, information about trends among LPs and on new terms and conditions. This way a placement agent can help ensure a good relationship with LPs. All this is worthwhile effort on the part of the placement agent because a good understanding of the firm and its needs takes time to develop, but once it's been established this acts as a natural barrier to a VC using another placement group.

Using a good placement agent can increase the odds for a successful fund raising but their exact worth is difficult to put a value on. Considering that the main reason GPs cited when choosing not to use a placement agent was the cost involved, fees seem to feature fairly low down in the considerations once having made the decision to use one. There are endless permutations to fee arrangements and negotiations can be protracted but, allowing for some variation in the quality of service, GPs feel they are comparable and not overly influential on the end decision of who to use. With several banks undergoing personnel changes there may be some concessions to encourage new mandates. Boutiques confident of their offering are likely to stand their ground. Boutiques with an excellent reputation in the market will generally see no need to change their fee structure, this is another story for new entrants or players that have to re-establish themselves in the market. It is generally not easy to compare bank boutique fee structures; banks might bundle several services into one fee proposal which could result in lower upfront cost but above market fees for additional services, boutiques are purely focused on one part of the process.

Ultimately placing power is the most important issue. "You're really buying their address book, it's the introductions you pay for," says Kevin Murphy, a partner at Indigo Capital. But how can a GP judge the value of placement agent's purported contacts? In theory it's easy to check the track record of a placement agent by looking at the size of funds they've raised but in practise it's difficult to get information on the number of new investors an agent has bought in.

Who's choosing who?

In the current climate the due diligence is just as likely to be the other way round with placement agents paying close attention to the quality of the funds they represent.

Murphy was impressed by the analysis CSFB's placement team did before accepting Indigo's mandate: "They took a serious look at us during the due diligence. The message was, 'we're choosing you as much as you're choosing us'," he says.

"The volume of due diligence has stepped up hugely in the last three years. We want more information from funds and we do more referencing," says Simpson. Helix sees 100 to 120 funds a year and will take on a maximum of five. Placement agents judge funds according to what investors have an appetite for as well as the quality of the funds. "There's a GP shake-out going on. There's not that many mandates out there that you really want," he adds.

Who needs a placement agent?

With institutional money so hard to come by, the core reason so many GPs use a placement agent is obvious. "There's no other choice," says Kanngiesser; "With direct investors reducing their commitments and a smaller fund-of-funds market you need to broaden the worldwide search for LPs." The type of funds using the service is changing and now includes some of the biggest names. In the current market all but a tiny minority of upper echelon firms, such as Permira and CVC Capital Partners, need to consider using a placement agent. But the decision is still not an easy one to make.

Placement agents feel that many GPs underestimate the changes LPs are undergoing and how difficult the fund raising process has become. One says: "Even with existing investors you have to work hard now. The promise of support is over-estimated by many GPs even when it's the case that the fund is attractive." No matter how well a VC thinks he understands LPs, his experience is not going to match that of a placement agent who is in constant touch with investors. Paying for their services buys knowledge of the market hard to find elsewhere. It's not always clear how institutions work but a placement agent should know exactly who to speak to and have an idea of how they are disposed towards the asset class.

For most GPs the alternative is cold calling investors, an unappealing and time-consuming activity that is often underestimated and keeps partners away from their primary duties. GPs feel that their placement agent may have a better chance of getting a meeting in the first place but they also maintain the momentum of the process, following-up and dealing with LPs' questions, and allowing the GP to take more first meetings.

Seibel says: "It saves time and makes us more efficient. It also helps us build a relationship with LPs, especially new investors." TVM has its roots in Germany and with Siemens as a founding investor it has strong connections with institutions there. One of the main reasons the firm used a placement agent for the first time was to boost the number of international investors. UBS Warburg helped TVM raise €128m for its latest fund.

Firms also turn to a placement agent when they are looking to expand. GPs can typically expect existing investors to increase their commitments by 20% to 25% for a successive fund but for a firm with ambitions to increase the size of its next fund beyond that a placement agent is key. Mezzanine provider Indigo Capital enlisted the services of CSFB to raise its fourth fund, the first time it had used a placement agent. The fund closed above target, and nearly double the size of its predecessor, at €475m at the beginning of this year.

With money harder to come by LPs have more influence and their preferences are encouraging the use of placement agents as part of the on-going professionalisation of the private equity industry. GPs feel a placement agent can speed up the decision making process. "Our LPs liked it very much, they like that with a fund raiser they get the standard process that they need," says Seibel. Kanngiesser says PolyTechnos's LPs fully encouraged the firm's decision to use a placement agent as long as the fees were paid from management's pocket and not by the investors. "They were concerned we spend our time on investments not fund raising," he says.

The placement agents known and trusted by LPs can come to be relied on to filter out the tide of lower quality funds that flood their desks. But this trust is not won easily. And LPs demand a higher level of due diligence from the placement agents. Cavell says: "The service Helix gives is highly respected by LPs as they have detailed knowledge of us."

Not all GPs have found that their investors welcomed the involvement of a placement agent. Murphy says: "Lots of our existing investors didn't get involved with the placement agent and from those that did the feedback was almost negative as they felt they were loosing their direct contact with us, but CSFB was very sensitive and stayed out of the process with existing investors." Cavell is another that stresses the importance of knowing when to use a heavy touch and when to use a light touch with LPs.

It looks like the increased demand for placement agents' services is to be a permanent feature of the private equity market. "It's hard to imagine going back to the market without any type of placement agent," says Murphy. Seibel says TVM will use the service even if fund raising conditions improve but others want to reassess the investor market before committing. Kanngiesser believes the need for a placement agent is reduced once a firm has reached critical mass and its track record is well established. "The value added decreases over time. The use of a placement agent depends on your ambitions and if you want to keep increasing the size of your funds."