Competition? What competition?

With the big fund raising splurge around the corner, placement agents are getting busier. Despite talk of a crowded and competitive market place, *Tom Allchorne* finds that there is more than enough work to go round.

There always seems to be people moaning that various parts of the private equity market are overcrowded: there are too many PE houses, too many fund-of-funds, too many fund managers; and there are too many placement agents. This is usually accompanied by much hand-wringing and predictions of a shakeout, to use the popular phrase. Yet this doesn't seem to be the case and an analysis of the market will tell you that if there are too many then we should be seeing firm after firm closing its doors and countless fund managers streaming out of offices with P45s in their hand. This clearly isn't happening and while it may seem that there are too many placement agents, the reality paints a different picture.

Top end

There are three types of placement agent: the investment banks such as CSFB, Merrill Lynch and Lazards; the independent boutiques, such as MVision, Helix, Campbell Lutyens; and the specialists which tend to be much smaller in terms of personnel and take on a limited number of mandates per year, like Doug Miller's International Private Equity, which has done work for the likes of 3i and Barclays despite the fact he makes up the entire team.

The top end of the market, dealing with the plus €£1bn funds, is dominated by the investment banks, and because there aren't that many of these funds out there, competition is naturally fierce, with fee-cutting aplenty. The reason the investment banks target these funds is simple: the small to mid-cap funds don't meet their revenue targets. The banks have much larger overheads than the boutiques and have to go for the mega-funds. In this sense, boutiques and the smaller specialists are better suited to private equity placement. Despite their size and resources, it is the investment banks that are most at risk during the quiet periods. The smaller firms can withstand a downturn because they have fewer overheads and they can afford to keep going with just the two or three people they have always had.

Because they have revenue targets to meet, the investment banks try to do as many deals as they can and this is what leads to fee-cutting. Fund raising can be a long-term business, and the large banks don't work on this sort of basis when calculating profits. Mounir Guen, CEO of MVision, says: "The revenue earned on funds raising now is generally lower than it was five years ago. Also, the fee is spread over time so it can take two or three years to break even and this is difficult in an environment where banks expect to be up 10%-15% year-on-year in revenue."

The problem with this approach is they will sometimes be forced to go for funds that aren't of the highest quality and are therefore going to linger. Guen says: "For some the strategy is just to wait your turn when it comes to winning mandates in the next year. If you go for one and you don't get it, you wait for another one. In our model we only go after number one and if we don't get it we don't go for number two or three."

With this sort of pressure, it is unsurprising that the top end of the market is competitive, especially because most of the larger funds can pretty much sell themselves and so there is little need to hire someone to do it. And when there are no funds about, it can get tricky for the banks.

Slim pickings

Last year was one of the slowest ever fund raising years, and placement agents naturally felt the pinch. "There were a lot of things in the industry that combined to fundamentally change the placement agents business," says Scott Church, managing director at Lazards and one of the team who joined from Merrill Lynch in February 2003. "It started in 2001 with the bursting of the tech bubble. When the market emerged from that placement agents had a lot more demands put on them for quality control and therefore you saw a lot of emphasis put on due diligence and the scrutiny of the various metrics you use in private equity. All of that reached a high level and so in 2003 everyone was coming to work with their new armour on and yet there was a dearth of quality funds. I think that the good placement agents used the last 18 months to adapt and ponder the question what our role is in private equity and where we add value to justify our fees."

Others just decided to give up the ghost. Deutsche Bank and JP Morgan were unable to struggle on through the bad times. The reason for their demise was a combination of market conditions, the investment bank culture and problems unique to them. JP Morgan for one was dedicating a lot of its time and resources to raising its own fund and so didn't allow the placement division to generate any money.

There is little doubt the placement agent business has changed over the last 18 months. "Pre-2003 banks had dominated the scene," says Church. "It is more fragmentary now. There are more boutiques with more differentiated models."

Winner takes it all

JP Morgan and Deutsche bank, among others, were Johnny-come-latelies to the industry anyway. They saw how well CSFB and Merrill Lynch were doing, decided they'd like a piece of the action and decided to copy them. They tried, they couldn't, and failed. Even Merrill Lynch, which, until last year, dominated the top end of the placement agent business alongside CSFB, has fallen on hard times, losing most of its team to Lazards.

And it isn't just the investment banks that can find it difficult. There is an unconfirmed report that Blackstone is to launch a placement business and has just poached eight members of troubled Atlantic-Pacific, which has already lost three of its team in the space of a year and rumours of more to come.

There have been a number of new entrants into the market, like Matrix and Constellation, the latter of which went from hedge funds into private equity. Like all newcomers, the task is not going to be easy. Andrew Sealey, a managing partner at Campbell Lutyens &Co, believes that while there have been a series of recent additions to the market, the barriers to entry are high and numerous: "To get quality mandates one has to be able to demonstrate historical success. If you have less high quality mandates they can be very difficult and ultimately unprofitable and therefore will make it harder to win new mandates. On the other hand, if you do have high quality ones, it's easier to raise them and therefore easier to win new ones. It's a vicious circle."

Plenty of room at the bottom

Stepping below the mega funds and into the world of the mid-market funds, the level of competition falls dramatically. Richard Sachar, chief executive at Almeida Capital, says his firm has too much work to do and the business has grown so much they are having to move offices. "How can the market be too crowded when you have new players, both big and small, coming into the market and others wanting to come into the market?" he says. "I know of a handful of investment banks that are considering coming into the market." This is not how a shakeout is supposed to work.

"Fee compression," argues Church, "is only a part of the market. There are other funds out there that are filling up the market nicely. It was crowded in 2003 because it was a low quality year. The beautiful thing about this business is it is dynamic, with new funds coming in to regenerate the industry."

Helping the needy

A lot of the new firms naturally find it more difficult to raise money than the Apax's or 3i's of this world despite the fact the big boys don't really need the help. This was why Sarah Clarke left Helix and set-up Foundation Fundraising Services (FfS), which started operating in January. Not a placement agent per se, it provides advice and preparation services to GPs intending to fund raise without the assistance of placement agents.

"Most placement agents are motivated by those funds with the more straightforward marketing focus," Clarke says. "They generally avoid the new funds. The funds that have everything get LPs and placement agents yet nothing comes to those that need the help. The smaller ones do their fund raising in-house or use a one-man band."

At Helix, Clarke used to see lots of funds rejected by the firm on the account of the fact that they were too small and/or the

money would be too difficult to raise. "I wanted to target those funds," she says.

FfS doesn't just target the smaller or new funds though. Clarke says there are a lot of GPs out there who already have good investor relations. "What they need is someone to take the burden off in-house resources. I have worked for a very large established fund that takes me on to do a PPM. They are doing the fund raising in-house but feel that it is helpful to have a third party taking a look and having someone do the creative work."

Travel agents

The emergence of a company like FfS is long overdue given how expensive placement agents' fees can be. In order to justify these fees, placement agents have had to try and differentiate themselves: "The placement agent business has changed over the last two or three years," says Andrew Sealey. "It has moved away from a business of relationships to a much more advisory, added-value type of business. This means advising on strategy, process management, and tactics, leveraging the relationships. It's much more about establishing a partnership with the GP."

Over the years GPs have become more demanding as private equity has become more mainstream. Richard Sachar says: "Private equity used to be a dark place. Buyers and sellers didn't know who each other were. Things have moved on. LPs are much more well known so there is no value in just connecting buyer and seller. The problem is that there are still people who think that connecting is enough and they are jumping into the market with an out-of-date model."

Setting up meetings is easy. LPs will always want to meet with GPs just to keep their databases up-to-date. It is no longer the job of the placement agent to sit at his or her desk with a rolodex and a telephone. "The GP has to be sure they have not just hired a travel agent," says Scott Church. "Quality of advice, understanding what LPs want and how they behave, having strong relationships, taking on the administrative burden of fund raising; these are all ways in which placement agents add value." It is about understanding a fund's unique selling point. "If a fund manager thinks a placement agent can get this, that's invaluable."

The end game

If the rumours are to be believed, the placement agent end of private equity is the place to be. New boutiques and interested investment banks don't seem to have been put off by talk of growing competition and fee-cutting. The reason is that everyone and their monkey knows that next year will be a big fund raising year; there will be plenty of work to go around and this is where the new entrants and the smaller boutiques can come into their own. All GPs want to use a team with a good track record, but those with the best track records will go for the easier mandates from the large and well-established firms. The mid-market is packed with firms eager to raise new funds next year and there is plenty of work to go round.