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Spoilt for choice?

Placing private equity funds is increasingly hard even for the most compelling propositions. But there are more than enough placement agents in the market ready to assist. Lisa Bushrod reports

Placement agent services are in boom time. Many of the firms that have now moved into this space have done so during the last two years leading many to speculate who will still be around in the next three to five years. Victor Quiroga of Paris-based placement firm Triago, which started operations in 1992, says: "When Triago started there were two or three [boutique] placement agents and today there are about 100. Our belief is that 60 or 70 of those 100 are going to vanish in the coming years. Investors will help in this reduction because what counts is what investors think about agents. Private equity funds want to go to experienced fund raisers and this is a very small number."

The boom has occurred in all tiers of the placement agent market. More investment banks have moved into the space, despite the fact that those that have been there for the long haul have been downsizing their teams of late. This downsizing is a result of the wider economic problems facing the investment banking community and the fact that less funds are being raised. European Venture Capital & Private Equity Association (EVCA) figures for the second quarter of this year show total new funds raised fell by 70 per cent compared to what was raised in the first quarter of this year - €1.6 billion to €5.3 billion, respectively. Significantly €4.9 billion of the €5.3 billion was raised from independent sources in quarter one this year whereas that figure fell to just €1 billion out of €1.6 billion in the second quarter.

The attraction for investment banks subject to lean times thanks to the downturn in M&A markets and the almost two year absence of fully working IPO markets is obvious. Not only does the placement agent business not require any capital adequacy commitment it's a straight fee-based business that some feel can be built on the back of their existing institutional relationships, others take a more dedicated approach.

As well as an increase in the number of investment banks that are building placement agent capabilities there are the boutiques, typically housing six to eight professionals plus support staff. It is here that the explosion has really taken place. Some entering the market are the result of teams or groups of individuals spinning out of investment banks. Probitas Partners, which was started in San Francisco in 2000, involved a group of ex-DLJ individuals who exited that team following the take-over by Credit Suisse First Boston. Currently awaiting FSA approval Probitas will then open for business in Europe from a London base. Others entrants to the boutique space, but by no means typical, include Almeida Capital, which was set up early 2001 by two ex-institutional investors frustrated by the service they received from some placement agents in the market.

Although placement agent activities began - at Merrill Lynch - in the 1980s it's taken quite a long time for the market to really develop. Admittedly that development currently looks distorted and the market, as many working within it suggest, is likely to shrink back to mirror the actual degree of expertise in the market - current, and learned over the next couple of years.

A reason for the delay in the development of the placement agent market in Europe is the fact that venture and private equity investing was fairly limited when the last recession of the early 1990s hit. Since 1992 and up to 2000, (when the technology bubble burst) it was, relative to today's market, easy to raise money. In fact in the early to mid 1990s the main hurdle was selling private equity as an asset class. The technology boom and sky high valuations of the late 1990s and the attendant returns on venture and private equity investing in this period certainly drew attention to the asset class and there was ultimately a lot of disappointment from those who jumped in during the bubble.

Given the up cycle GPs were riding most were able to go out and raise money on their own without too much difficulty and in a short enough time period as to not be a serious distraction from the real business of investing. Even billion dollar fund raisings were seeing closes within a six-month period as opposed to today's expectation that fund raising will take between 12 and 24 months, depending on the proposition. So in stepped a swathe of newly formed placement agents to assist in these difficult times.

Understanding the vagaries of the new institutional investment landscape is the key for placement agents to be successful. Some institutions are more helpful in their feedback on a fund than others. "The Scandinavian institutions will give a lot of feedback on a fund. If the hurdle rate is five, for example, they will tell you that they won't look at anything less than eight," says Anne Gales, director at Continental Capital Partners. As always, operating in Europe is about understanding the individual markets rather than treating them as a whole. "If for example you have a German institution, it will most likely invest in private equity groups in Germany directly and may even invest in European groups also, but it will most likely invest in the US via fund-of-funds. As its private equity programme increases in size it may begin to bring more of the management in-house," says Mounir Guen, CEO of MVision.

Europe also works to its own, often undefined, timetables. In the US the market is reasonably structured with institutions committed to a year-on-year private equity investment programme assigning an allocation at the start of the year. The year is then effectively split into quarters and the quarters themselves into two sets of six-week periods. The first six weeks of a quarter being the time to review new investment propositions and the second spent on the due diligence and decision-making process. For this reason funds are unlikely to get in to see a US institutional investor without a good deal of prior notice. In Europe the situation is markedly different.

While some of the bigger investors do have annual allocations the timetable is much more fluid and it is relatively easy to set up a series of meetings. Getting positive or otherwise decisions to follow on from those meetings, however, is not structured. “In this market the big investors probably see three or four funds a day and then take the time to analyse them in the context of what else they have seen, such as by sectors or countries,” says Gales.

Many European institutions have expressed a desire for greater alignment with the funds in which they invest and becoming a cornerstone investor in a fund is one way some institutions feel they will achieve this. A typical cornerstone investor will seek a share of the management company. “Cornerstone investors have become very important. A lot of small investors feel more comfortable coming in when a cornerstone investor is in place. It’s still important to have two or three leading names stepping up so it can be very difficult in terms of timing, especially in Europe where everyone wants to stick to their own timetable,” Gales.

While a cornerstone investor can work to the benefit of both the fund - helping it get off the ground - and the investor they also come with a raft of health warnings. Any degree of involvement by the cornerstone investor that leaves the impression that the fund is essentially semi-captive is a big turnoff to other investors in the fund. Captivity is not the preferred route for most institutional investors, many of which will be working within a similar corporate culture and as such understand the pressures that an organisation can bring to bear thereby undermining the autonomous status. (*See BUYOUTS this issue for the sizeable list of fund managers that have opted to shrug off their captive status and widen their funding appeal*.)

Doing the placement business

Most placement agents are proactive in their choice of private equity and venture managers for whom they will raise funds. This goes far beyond the whittling down of 200-odd approaches a year that ultimately result in ten or less fund raisings being assisted. Such ratios are typical of those described by all types of placement teams such is the demand for their services. Instead being proactive involves the placement agent going out into the market to cultivate relationships with private equity and venture managers it would like to work with at some point in the future. “We avoid talking to GPs that are too close to fund raising because they have a different mental attitude at this time. We prefer to get to know them when they have no need for our services. It’s better to talk about things that have gone wrong when they are not in fund raising mode, especially to hear things like how they got out of a tough situation,” says Quiroga.

Although there is a scepticism in the market about the longevity of some of today’s players those that do get to know each other will refer business to one another and work on joint mandates. Although, admittedly, the joint mandate scenario is invariably described as workable in only the most exceptional and highly stipulated circumstances. Most ultimately prefer to work alone. “We always ask [a fund] who they have been to see and we always tell them who they could go and see. We tell people to go and see other placement agents because our approach isn’t right for everyone. All of them have come back to talk to us so far. Not that we have taken them all on!” says Richard Sachar,

Funds raised 2001

	Origin of funds 2001		Funds raised by country of management 2001	
	€m	%	€m	%
United Kingdom	6,817	17.8	20,485	53.6
Germany	4,339	11.4	3,713	9.7
France	4,197	11.0	5,492	14.4
Italy	1,662	4.3	1,875	4.9
Netherlands	1,616	4.2	716	1.9
Sweden	740	1.9	1,815	4.7
Belgium	714	1.9	651	1.7
Switzerland	545	1.4	667	1.7
Spain	520	1.4	751	2.0
Finland	418	1.1	407	1.1
Norway	363	0.9	366	1.0
Denmark	358	0.9	494	1.3
Ireland	198	0.5	210	0.5
Austria	153	0.4	137	0.4
Portugal	133	0.3	118	0.3
Greece	41	0.1	51	0.1
Poland	10	—	176	0.5
Iceland	8	—	6	*
Czech Republic	3	*	24	0.1
Hungary	1	*	60	0.2
Slovakia	0	—	5	*
Other European	243	0.6		
Unknown European	2,306	6.0		
European total	**25,383**	**66.4**	**38,219**	**100.0**
Asia	1,202	3.1		
Canada	151	0.4		
Israel	—	—		
USA	9,594	25.1		
Other rest of the world	1,014	2.7		
Unknown rest of the world	875	2.3		
Total rest of the world	**12,835**	**33.6**		
Total	**38,219**	**100.0**		

*Value below 0.1%

Source: EVCA

CEO of Almeida Capital & AltAssets, which expects to be raising less than a handful of funds in any given year.

Almeida Capital's approach is intimately linked with that of its AltAssets branch, which is a supplier of private equity related information to the LP community. The links fostered through AltAssets have enabled a comprehensive database of LP investor requirements to be catalogued, which Almeida Capital accesses when assessing whether or not it can add value to a particular fund raising process and what the level of appetite is for that proposition. The model was borne out of Richard Sachar and Jamille Jinnah's frustrations with the placement agent processes during their time spent as institutional investors.

"We could have set up on our own and quietly placed a fund and we would not have had to raise external financing. But we felt that would just be doing what a lot of other people are doing and would not differentiate us. I think a number of people who have just jumped into this market are going to struggle but we think we have built something stronger than that over the last two years," says Sachar.

"Some people use a placement agent because it's the best use of their time"

Everyone in this market talks about the importance of robust due diligence and for the most part the understanding of what that means appears to be universal, although there is some suggestion that this is where some of the new entrants will flounder. "We carry out the due diligence we would expect investors to carry out. Then we know the problems. There is no perfect mandate and if there is they won't use a placement agent, although some people use a placement agent because it's the best use of their time," says Charles Cecil at Helix Associates. Helix Associates has been in the placement agent business in its current guise for nine years.

Jamille Jinnah, managing director at Almeida Capital & AltAssets, agrees with Cecil's sentiment: "We would not take a fund to an institution unless we would invest in that fund ourselves, and we used to be LPs. When investors speak to you about a fund you need to be able to talk confidentially about it and know the market generally. A PE firm also wants to know that you have the analytical skills to get through the fund raising process successfully." He goes on to say: "If we discover anything wrong we have the contractual right go to the LPs and inform them. We include this clause because we need to protect our relationship with institutional clients." It is, after all, as Victor Quiroga of Triago suggests, the institutional investors that will ultimately determine which placement agents survive and those that do not. Grooming fund managers in the art of communication and presentation and focusing their minds is, along with due diligence, one of the most pressing issues for placement agents before letting their PE fund clients loose on their all important institutional investor contacts.

Although paid by the private equity and venture fund managers via the institutional investors' management fees a placement agent must work with a fund while maintaining an exemplary relationship with institutional investors so they are assured that the investor will want to do business with the agent on the next fund raising. For this reason most placement agents invest heavily in databases and their upkeep so that they can monitor investment preferences, among other things, to ensure they are not wasting the investor's time with unsuitable propositions for their portfolios.

On the subject of fees it is worth noting that there is a variety of approaches to how these are paid. The typical scenario involves fees being paid down over a three year period, but up to as much as five, out of management fees. However, a percentage share of the carry is sometimes claimed. The camps are divided on this point - some see no problem in the concept and others are adamant that carry is for incentivising the fund's management team and that it should retain that sole purpose. Those in favour often reduce or wave placement fees in favour of a share in the carry of the fund. They see this as positive from the point of view of institutional investors who can infer that the fund is of top quartile quality, or thereabouts, if the placement team has enough confidence in it to forego their fee for greater, later riches.

By virtue of their position has an interface between the fund and the institutional investor some firms have developed related and lucrative businesses. Triago for one has a thriving secondary placement business. "Fifty per cent of our work is in the secondary market helping investors get out of funds. We did our first secondary transaction in 1993 when we helped a French bank sell most of its PE funds and today we do a secondary transaction almost every two weeks. GPs are always sad when an investor has to leave the limited partnership and they are even sadder when the replaced LP has to leave so they are really interested in selling to a party that will keep the partnership going forward. Most of the money being attracted to this market is ad hoc and price is not the centre of the discussion," says Antoine Drean at Triago.

Institutional investors take control

There appears to be universal agreement that institutional investors are increasingly sophisticated, even in Europe where the tradition of private equity investing has nothing like the depth and breadth of the US market. "Investors have become more and more demanding and more knowledgeable about the questions they have to ask about any particular team," says Cecil at Helix Associates, which focuses part of its business on US funds seeking to broaden their investor base into Europe. Nick Hofgren, EMEA director of the private fund group at JP Morgan Chase notes this area of European business is a growing trend: "European institutional investors are looking for a lot more European-based GPs than they were five years ago."

Valuations and transparency are both things that investors have become much hotter on with the downturn and slow down in the markets. "Our view is that there has been huge change over the last 10 years. There is more consensus about the correct approach. You are not in the realms of certainty with valuations so it is good to have a degree of flexibility and it's the job of LPs to judge whether there has been an unnecessarily liberal interpretation of the rules," says Cecil. The degree of flexibility he refers to is the two different sets of valuation guidelines produced by the EVCA and British Venture Capital Association (BVCA.) Given the degree of trust involved in an investor/ investee relationship of this length of time (typically ten years) Cecil concludes: "Transparency and valuations should be bomb-proof."

Hofgren speaks of the experience of many placement agents when he says: "Institutions are now asking for reporting in a standard that they like. It was a GP-led market between 1992 and 2000 and that situation has now changed significantly. We believe that GPs will be doing more to accomodate institutions' requests for flexible reporting."

Mid market and venture

"In Europe some institutions are much more interested in mid market deals because they understand their significance and so can feel more emotionally-inspired by the mid market than they do by large buyouts. But there are not as many middle market players in Europe as there are in the US even though they are roughly equivalent sized economies," says Hofgren. Five years ago, when Hofgren moved to London to place European institutional private equity funds, investment banks in general concentrated primarily on £500 million plus mandates, which then was firmly the arena of LBO transactions. Tightness in the market and investor preferences has seen a lowering of investment banks thresholds generally. Although they are not, for the most part, competing in the €300 million mid market range favoured by the majority of placement boutiques. By and large it follows that an agent will work in the end of the market necessitated by its cost structure.

The lack of performance of many venture and some private equity investments has led to a desire among institutional investors to build long term relationships. Arguably this has always been the case for fund managers who would need to have a good explanation for the absence of a previous fund investor in a follow-on fund. "When I first started, an institution, who decided to invest in private equity, would identify half dozen major General Partners, and allocate them a significant amount of money. Today, the investors seek to identify value and the returns in more detail, hence fund-of-funds and consultants are used much more in terms of deploying capital," says Mounir Guen, who left behind 14 years at Merrill Lynch's private equity placement business last year to found MVision. Identifying value is a commonly-used phrase. It becomes all the more meaningful given the fact that many institutional investors trusted their private equity portfolios to brand names that simply failed to perform. This is true for both private equity and venture.

"Venture is obviously the most tricky area of all. It's by far the largest part on a money-on-money basis but most has come in the last few years so while you can look at performance it is skewed by this fact. It will be two to four years from the reversing of the bubble before we see who has come through in reasonable shape," says one agent. Guen explains how the venture investing market currently works: "Today's investors in venture fall into three groups. The first have no boundaries - they usually favour the US because it's older and its track record is more mature whereas Europe is regarded as still fairly new. The second will have regional allocations, and they will adapt to invest in European markets. And finally there are local investors who have a very good understanding of their local market and will play the cycles because they know what's hot. For example, the Nordic countries are ripe for VC deals, and local investors will know who locally is best positioned to benefit from this."

Funds raised 2000/2001

Funds (in € x 1,000)	2000		2001	
Private equity raised by source	**Amount**	**%**	**Amount**	**%**
Independent funds raised in year	33,233,690	69.2	28,005,944	73.3
Amount raised by captives	10,776,344	22.4	8,410,713	22.0
Sub total new funds raised	44,010,034	91.6	36,416,656	95.3
Realised capital gains	4,013,355	8.4	1,802,115	4.7
Total funds raised	48,023,389	100.0	38,218,772	100.0
Private equity raised by type of investor				
Corporate investors	4,787,360	10.9	2,154,160	5.9
Private individuals	3,269,779	7.4	2,428,029	6.7
Government agencies	2,444,958	5.6	2,190,771	6.0
Banks	9,554,114	21.7	8,735,023	24.0
Pension funds	10,654,717	24.2	9,776,204	26.8
Insurance companies	5,687,227	12.9	4,622,410	12.7
Fund-of-funds	5,017,284	11.4	4,268,328	11.7
Academic institutions	197,928	0.4	744,787	2.0
Capital markets	552,726	1.3	198,244	0.5
Not available	1,844,149	4.2	1,298,700	3.6
Sub total new funds raised	44,010,241	100.0	36,416,656	100.0
Realised capital gains	4,013,148	—	1,802,115	—
Total funds raised	48,023,389	—	38,218,772	—
Geographical breakdown of private equity raised				
Domestic	25,185,453	52.4	18,338,714	48.0
Other European countries	9,930,479	20.7	7,044,706	18.4
Non-European countries	12.907,458	26.9	12,835,352	33.6
Total funds raised	48,023,389	100.0	38,218,772	100.0
Expected location of funds raised				
High-tech early stage	8,623,729	18.0	5,585,861	14.6
Non high-tech early stage	1,221,559	2.5	1,143,500	3.0
High-tech expansion/development	6,611,281	13.8	3,975,736	10.4
Non high-tech expansion/development	5,688,360	11.8	4,323,967	11.3
Venture capital	22,144,929	46.1	15,029,064	39.3
Buyout	24,346,654	50.7	21,540,950	56.4
Not available	1,531,806	3.2	1,648,758	4.3
Total funds raised	48,023,389	100.0	38,218,772	100.0

Source: EVCA