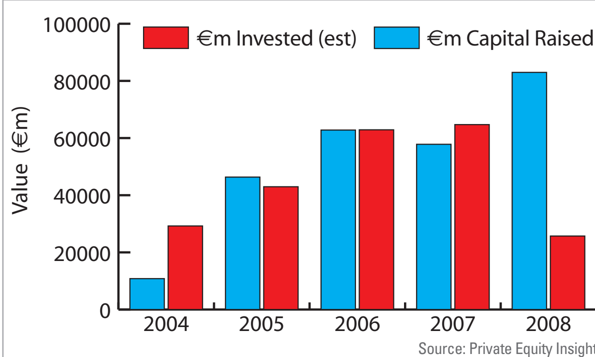
Time to reset the bar

Norwegian LP Argentum recently received a government rescue package of NOK 2bn in response to a dearth of capital in the PE industry. **Rikke Lilla Eckhoff** investigates how funds will fare in this new environment.

In January this year the Norwegian government presented a NOK 20bn fiscal stimulus package, of which the Ministry of Trade and Industry has allocated NOK 2bn to the government-backed LP, Argentum – the only investor in Norway that exclusively invests into private equity and venture capital funds. The extra funds are welcomed by the industry, particularly by venture firms. "Growth companies are worst hit in a financial crisis as they depend on capital injections to expand," explains Maria Borch Helsengreen, director of business development. "If LPs turn off the tap on venture investments, this could be extremely damaging for start-ups," she continues, adding that like any other LP, Argentum will select funds on performance, regardless of venture or buyout.

Capital raised by buyout funds vs equity invested, 2004-2008



Source: Private Equity Insight

Norway's Scandinavian neighbours are calling for similar measures. In Sweden, however, it seems a far-fetched plea. "As the Swedish pension funds are organised differently to Argentum, which operates as an independent LP, it is unlikely that the government can support SMEs and the PE and venture industry through the same means as they have done in Norway today," CEO of the Swedish Venture Capital Association (SVCA), Marie Reinius, explains.

Then there is the over-commitment strategy of LPs and "the denominator effect," the combined result of which is leading LPs to seek to get out of their commitments. Capital needs for both LPs and funds are higher and accelerate at a faster pace than before, as exits are coming later than planned. Many LPs therefore say they will only commit a minimum subscription to the top-tier funds. Consequently, fewer funds are planning to raise, and instead opt for top-ups of existing funds as a failed fundraising round could taint a fund's reputation. Some larger funds are even downsizing, such as the case of Permira – reported in *Nordic unquote*" last month.

Moreover, statistics from 2008 show decreasing levels of capital invested, as both investment activity and deal values plummeted. Judging from the activity in the first month of 2009, GPs will continue to prioritise add-ons and portfolio management rather than venturing into new forays. As the graph above depicts, recent years have seen the amount of capital raised being level with investment activity across Europe, while in 2008 there is a huge discrepancy, with deal volumes and activity dropping across the region. It remains to be seen if the charts for 2009 will show two equally feeble columns, or the opposite discrepancy with no fundraising, and a feast of deal-doing.

Power shifts?

In a recent comment, law firm SJ Berwin predicted a power shift in LP/GP relations after a period of "money chasing deals" where terms and conditions have been leaning towards the GPs. This, though, would require a concerted effort on the part of the LPs. One topic on the table is GPs management fees; some are calling for a review of the fee structure, while others feel the debate has lost its focus. "LPs are right to call for alignment and responsibility. Attacking the fee structure is not the issue, avoiding excesses is," argues Mounir Guen, CEO of the placement agent MVision.

Although it shows a decline in interest and allocations, numbers from a sentiment survey by placement agent Almeida Capital do not resemble the dramatic outlook portrayed in the media, actually revealing that more than three quarters of LPs intend to maintain or increase their allocations to private equity in 2009. Combined with the deal statistics and performance reviews, a resetting of expectations will be unavoidable. With less leverage, risk is reduced for the investor, and thus LPs are also forced to lower their return requirements. Additionally, as the Nordic market matures, returns could diminish as seen in Europe and the UK in recent years. "This is a case of everyone adapting to the current market conditions. In three to four years, we will adapt to new hopefully more favourable, conditions again," Guen concludes.

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