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LP/GP communications: The eight channel model

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THE BALANCE OF power between LPs and GPs has traditionally been finely poised. The supply of capital from LPs has increased, while buyout houses across the market have continued to raise ever larger vehicles. Since access to the best performing funds can still be an issue for some LPs the market has been characterised by a shift in power in favour towards the best performing GPs. Richard Moon of IE Consulting explains that a sophisticated, eight channel LP communication strategy has enabled those GPs to select and maintain an investor base with a spread and quality of investors that is conducive to a long-term supply of capital.

Historically, many private equity houses have had very limited contact with LPs when they have not been fundraising. Today, with increasing competition across the private equity ecosystem, GPs have responded by developing investor relations strategies that are far more sophisticated than those which were the norm only three or four years ago. The prevalence of so much soft marketing before a formal fund launch, for example, is a direct consequence of the development of investor relations initiatives. The logic is clear; if you manage relationships through the life of the fund, institutions are more likely to re-up. This drive has unquestionably gone some way to redressing the asymmetry of information in the LP/GP relationship and to address the push for greater transparency, whereby LPs are asking GPs for more information rights and a larger and more involved advisory committee, for example. It can be argued that the rapid development of investor relations units has emanated from a much more demanding LP base, which requires a better quality of information flow in terms of both disclosure and immediacy.

Healthy returns in private equity funds has guaranteed a steady flow of capital back to their investors and led to a general increase in allocations to the asset class. With the increased importance assigned to private



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equity has come a more sophisticated approach to monitoring allocations. More investors in need of more detailed information has had a significant administrative impact and private equity houses have recognised the need for greater resources. 'Most GPs work to a three-to-four year framework and every time a group comes to fundraise, it must feel like it is starting from scratch. The process is extremely labour-intensive and distracting but by having more consistent, stable and direct contact, GPs can minimise the impact. Coordinating that process is crucial for a GP,' says Mounir Guen of MVision.

Clearly performance is the key differentiator, but the aggressive fundraising environment of the last 18-24 months has highlighted the need for an attentive LP communication strategy for many GPs. A good communications strategy and an established relationship gives LPs a degree of comfort when it comes to making a re-up decision, while a secretive attitude makes groups nervous, even where performance is strong. For the majority of LPs, it is not necessarily breadth and depth of communication but accessibility and willingness which dictates the success of the GP/LP relationship. Janet Brooks of ECI Partners concludes; 'A diligent investor relations programme gives comfort to an LP that it is dealing with a professional organisation. Yes, an investor wants to see strong returns but also in a reliable and appropriate manner. The industry has come such a long way in its approach to investor relations that it is hard to differentiate by the quality of our LP communications. The question for us now is where do we go from here?'

There are many determinants which affect the level of contact LPs have with a given GP; these include the size of GP, size of commitment, proximity of next fundraising, performance and GP location. Across the board, however, LPs are keen to see where the real value is achieved. They want to know the composition of

previous funds' IRR and to have access to information regarding corporate governance issues, such as the process the team uses to select investments. LPs with large, well-established programmes invest in a wide range of funds and are professional in the way that they analyse those investments. 'A GP has come to realise that a pension fund or a fund-of-funds will be answerable to investors of its own, often facing reporting demands for investment performance information. The convergence in the type of information required by a large proportion of LPs has determined what is now common practice,' explains Michael Halford of SJ Berwin. Such institutions might welcome timely information on fund performance but will expect little additional contact. Other, often smaller investors might expect the communication of more diverse information with high-net-worth individuals, for example, adopting a less formal approach but more likely to appreciate excess information. Managing the varying expectations of individual investors represents an ongoing challenge for a GP.

While the need to monitor their own investments is one factor in the increased demands placed by LPs on GPs, a thirst for market intelligence has also played a role. 'A lot of LPs are in a strong and pretty unique position to view the market,' says Brian Blakemore of Barclays Private Equity. 'When a limited partner is investing in 50 funds in different geographies and targeting different segments of the market, it has a wealth of information at its disposal. These guys have an insatiable appetite for information that will help them refine their investment programmes and

benchmark performance,' he continues. The popularity of the asset class has also attracted more institutional investors, all needing to fill information books and welcoming communication with general partners.

In the past, the establishment of an investor relations function might have come down to the decision of whether to manage such a function in-house or to outsource, and that choice would have ultimately come down to cost. Internal placement teams make economic sense in larger funds, while smaller firms do not have the management fees to justify an ongoing investor relations service so will use a more cost efficient solution such as a placement agent. The increasing size of GP funds, as well as larger numbers of LPs investing in the asset class, has led to GPs needing to manage relationships with hundreds of investors. As fund sizes have grown, the corresponding rise in management fees has offset the increase in obligations to investors. As the scale of a GPs fundraising has risen, so has the amount of work that can be outsourced. 'A large degree of the investor relations process can be outsourced but the core responsibility must be retained. The bigger the fund, the more crossover there will be in information and an efficient investor relations strategy is invaluable in ensuring that the whole process runs smoothly,' reminds Guen. The motivation of larger groups with an investor relations department that still use a placement agent through the fundraising process is largely in order to improve the quality of their LP base, cut down fundraising time and for new strategic propositions such as gaining exposure to new geographical regions.

Eight channel model

Based on the terms of a legal contract between an investor and a GP, there is an obligation only for very basic detail on fund performance, but in reality LPs expect – and receive – a lot more. Coded access to online reports, one-to-one meetings, investor committees, advisory boards, regular calling programmes, marketing materials and PR are all communication channels employed by various GPs. IE Consulting, a consultancy group affiliated to Incisive Media, has identified eight principal communication channels in which GPs disseminate information to LPs. Each of the channels fulfils a different objective in the communication process, presenting GPs with an opportunity to differentiate themselves from their peers and strengthen relationships with their investor base.

Fund report

A fund reports represents the most important part of any LP reporting. The majority of fund reports are now quarterly, although some funds will still report on a six-monthly basis. A report will typically include portfolio company information, valuations of portfolio companies,

fund level information and market information. Generally, LPs want consistency of accounting standards, content and format, but very much value differentiation around softer issues.

1-2-1 Contact

Face-to-face contact is widely considered to be a key element of the GP communication process. Meeting at least once a year, generally at a half-yearly point in relation to the investor meeting is an effective way for LPs to monitor the portfolio and for GPs to incorporate feedback. Some institutions find that investor relations executives provide a one-stop-shop for all the information they require. Increasingly, however, LPs are showing interest in meeting deal-doers and those team members with which they generally have little contact in the course of their normal market dealings. Institutions generally want relations with the people that are doing the deals and generating the value.

Ad hoc contact

Communication in the form of emails, telephone calls and letters from GPs is generally considered be a key channel of information flow by LPs. LPs would typically expect this sort of information



from current GPs as well as groups in which they are not invested. Email contact is considered to be the most valued medium for dissemination of event-driven information such as new investments, realisations and team changes. In the current market GPs are focusing efforts on achieving a steady level of contact with LPs, rather than the fundraising-driven peaks and troughs of the past, and ad hoc contact is a good way to achieve this.

Marketing

Marketing materials are a common but less popular method of communicating with LPs as many feel that it contributes to their information overload. Many LPs struggle to see the value in newsletters and other marketing materials that are too general or where the information is already available from another source.

AGMs

Annual meetings are widely regarded as an opportunity to receive information, meet GP executives and other LPs in a more informal setting. By and large, LPs prefer company presentations to represent performance across the board rather than simply the best performing companies. It is considered that analysis of a variety of companies allows a more accurate understanding of how a team operates in a broader range of circumstances. 'Both parties find the AGM a useful exercise,' says Janet Brooks of ECI Partners. 'The rigour of having to sit down and analyse things, ask questions, meet the CEO etc brings the LP-GP relationship to life, so to speak. It is also a great introduction for new personnel while input from investors, both prior to and following the day, makes it productive for all parties,' she explains.

Hospitality

Hospitality is utilised by LPs where it is considered to provide an opportunity to meet/talk to GP team executives and other LPs informally. In general, the pendulum has swung away from pure

hospitality events towards information-driven occasions. Many LPs only feel comfortable accepting hospitality specifically linked to a business agenda, while a minority of LPs were unable to accept hospitality or had a corporate policy that restricted acceptance in some way.

Advisory committees

Agenda items for advisory committees include valuations, conflicts of interest and a portfolio review. Other agenda items can include succession issues, GP team changes, deal pipeline overview and performance issues. For those participating, advisory committees can represent a significant opportunity to access deeper information, further understanding of strategy, team interaction and market intelligence, as well as getting an early heads-up on potential issues and conflicts. Advisory committees typically incorporate up to 12 attendees and meetings. Characteristically the committee will include a representative from investors that make the largest commitments to the fund. It could be argued that the advisory committee would benefit from incorporating a more diverse set of attendees from different types of LPs (in terms of organisation type) and different geographies. Additionally, GPs could make a value judgment regarding what an individual could bring to the debate, and select a committee accordingly.

Intranet

Intranets are seen by LPs as a complementary channel of information, rather than as replacing something else. The use and implementation of limited partner intranets (providing an online archive of all fund reports for example) has significantly increased recently. While the majority of LPs would value a client intranet, groups were keen to stress that such tools should be seen as supplementary to more traditional channels, with GPs continuing to make more proactive, direct contact with LPs through ad hoc, event-driven emails and telephone calls and face-to-face meetings.

If you're looking to develop your relationships with LPs or advisors, or if you need to understand how current and future industry developments are likely to affect your position in the market, we can help. In fact, if you need help with anything from commercial due diligence to competitive intelligence or from proprietary deal origination to providing content for marketing materials, we'd love to hear from you.

To find out more about how we can help your private equity business flourish, contact Matthew Craig-Greene
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