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LPs open-minded on multi-product managers - AVCJ Forum

THE PERCEPTION THAT PRIVATE EQUITY firms introducing additional strategies will boost their fee income but at the expense of overall returns is unfounded, provided expansion is conducted thoughtfully and alignment of interest is maintained.

There is inevitably a degree of wariness when an established private equity manager branches out into credit or infrastructure. As noted by several speakers at the AVCJ Australia & New Zealand Forum, fundraising for those two strategies has benefited from liability-based investors moving out of bonds and into asset classes that offer a similar yield-bearing structure with a potentially higher return.

"Some managers are being opportunistic about it," said James Lilico, an investment manager at Sunsuper. Ken License, a managing director at Principle Advisory Services, warned of "troubled times ahead" for some groups that expand too quickly. "It comes down to skill sets and DNA but also how are they going to take advantage of their own capabilities to expand their business," he said.

However, there are examples of successful transitions into the multi-product space. MLC was one of the LPs in Bain Capital Private Equity's debut European fund, which closed at $500 million in 2001. Alicia Gregory, head of private equity at MLC, described how the MLC team got comfortable with the product ingredients – including the notion that it was complementary to Bain's core business – and were vindicated by a 2.7x net return.

"It's not black and white that single-product is better, or that multi-product is evil or great because you can deploy lots of money," Gregory said. Nevertheless, she noted more due diligence work is often required for managers adding new strategies and those that raise money quickly – without leaving enough time to answer questions from LPs – will prompt concerns about alignment of interest.

Bain is one of a clutch of global private equity firms that have established themselves across a range of different products; the Bain offering currently includes private equity, credit, public equity, venture, real estate, and impact investment. Mitchell Stack, a managing director with the credit business, said one of the advantages of this approach was high-level discussions among people from different divisions, which leads to a deeper understanding of the investment environment.

Another benefit is scale. James Carnegie, a senior managing director with The Blackstone Group, noted that the firm's diverse relationships with banks across the world – "We pay a lot of fees to a lot of people," he said – is a strong source of deal flow. It also enables the likes of Blackstone, which has a product offering equal in breadth to that of Bain, to attract and retain talent more easily.

From an LP perspective, working with a manager across multiple strategies makes an institution a more relevant and valued partner. As a result, it is easier to win allocations to hard-to-access funds and get co-investment opportunities. However, LPs that make fee minimization the overriding rationale for backing a multi-product manager expose themselves to adverse selection risk.

"You should choose what kind of market and exposure you want, do your research and choose the best manager out there, whether single or multi-product, and then you negotiate the best fee you can negotiate. If you don't do it in that order you might not get the best outcome," said Stack.

Lilico added that Sunsuper entered into certain historical investments with a view to minimizing fees and found itself still cleaning up the mess years later.

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