Four Emerging Trends for LPs: A SuperReturn Recap

Kyri Yiannakis, EMEA Head of Client Development | Ipreo Private Capital Markets

At the 2017 SuperReturn CFO/COO Forum, over 150 attendees from both GP and LP firms had an opportunity to discuss the concerns and priorities affecting private capital investors. Rising to the top of the list were four trends that suggest LPs are adopting a more thorough and attentive approach to evaluating and monitoring the quality and stability of their investments.

Enhancing operational due diligence. Many LPs are now expanding their due diligence activities to include a wider range of GP operations. Whereas due diligence has traditionally been an arm's-length exercise, a growing number of LPs are now choosing to take a more hands-on approach as well as expanding the types of operations to be scrutinised.

A number of LPs reported that they were now making the trip out to the GP's place of business and conducting on-site due diligence. LPs also reported that they were examining the GP's technology platforms and human resources. By ensuring that the GP has a succession plan in place for managing partners, an effective talent retention strategy, and up-to-date technologies that support business continuity, data security, and data integrity, the LP can gain comfort around the GP's ability to manage the overall portfolio efficiently and reliably.

Re-examining value creation. LPs expect to see a good return on their investment, but they are becoming more sophisticated in the way that they evaluate the GP's impact on that return. No longer satisfied with a return that looks good on paper, LPs want to see what the GP did to create value beyond the industry or market average. LPs are asking GPs to break down value creation into components such as revenue growth, margin growth, and multiple expansion, and then looking at the components of each as they relate to gains that were realised through acquisitions or attributable to the growth or decline of the overall market or generated organically.

> By digging deeper into the mechanics of value creation, LPs can more accurately evaluate the performance of their GPs.

Improving reporting quality. In every region, LPs are seeking to improve the accuracy, thoroughness, and timeliness of the data. Reporting standards among European GPs tends to be reasonably thorough, although timeliness can be an issue. When it comes to reporting from GPs in the US and Asia, LPs struggle with both the timeliness and the completeness of the data. The issue is especially prevalent in the VC space, where investors may only be given the name of the investment and a valuation number.

Associations such as Invest Europe and the Institutional Limited Partners Association (ILPA) are working towards creating an industry standard for GPs to adhere to, but these efforts are being met with resistance from some GPs who may find it challenging to meet the new, more rigorous requirements or question the value that their LPs see from the templates and reporting standards being proposed.

Requiring greater transparency. Since the financial crisis, the issue of fees is at the forefront of every investor's mind, and LPs are examining fees and expenses more closely. While the disclosure of management fees is generally considered to be clear, LPs are reporting that they are seeing a rise in the hidden fees being charged. It's a sensitive topic that is causing trust issues between LPs and their GPs. While the cap on management fees over the life of the fund has helped to avoid issues such as zombie funds, LPs are still finding that they need to be vigilant in other areas. For example, GPs are allocating a wide range of fees into the "other fees" category, leaving LPs in the dark about what those fees consist of.

LPs are also concerned about the tax payments made by GPs. While they don't necessarily need to know the exact amount of tax that's paid by the GP, LPs do want to know that all required taxes are being paid, and they are concerned about the risk of tax avoidance.

Key Takeaway

LPs are becoming more sophisticated and more proactive in their approaches to evaluating their investment options and monitoring the performance and value of their investments. By pushing for greater transparency and examining the operations and performance of their GPs in greater detail, they are hoping to see better returns in the near term and make wiser investment decisions in the long term.