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INDUSTRY NEWS

Investors Begin to Get Picky on Manager Selection

Nearly two in five investors say they expect to decline to commit fresh capital to existing general-partner relationships, a Coller Capital survey shows

A view of the skyline of downtown Phoenix, where the Arizona Public Safety Personnel Retirement System is based.

PHOTO: ROSS D. FRANKLIN/ASSOCIATED PRESS

By Preeti Singh
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Investors say it's a great time to back private-equity funds, but they are also starting to make some tough decisions in deciding which fund managers in their portfolios they will continue to support.

In a recent survey conducted by secondary firm Coller Capital of 111 investors in private-equity funds, 41% of respondents said they are more likely to decline investing in new funds being pitched by managers in their portfolios than in recent years.

Many established private-equity firms are used to building long-term relationships with their investors across multiple successive funds without significant modifications to their investor base. That may be about to change as more firms face turnover among their ranks or their funds fail to deliver the performance they had projected when the funds were being marketed.

“Many LPs have now been in alternatives long enough to see some firms are just mediocre and their poor returns aren’t just a matter of conservative valuations,” said Mark Steed, Chief Investment Officer of the Arizona Public Safety Personnel Retirement System.

Mark Steed, chief investment officer of the Arizona Public Safety Personnel Retirement System
PHOTO: ARIZONA PUBLIC SAFETY PERSONNEL RETIREMENT SYSTEM

The Arizona state pension manager, for one, over the past year passed on new funds from some of the private-equity managers in its portfolio because of the departure of key employees or because excessive growth had left firms unable to invest as effectively as they had in the past, particularly in a more competitive deal environment as the “elbows get sharper,” according to Mr. Steed.

Among those Coller Capital surveyed, 82% said weak performance would be the most important reason for turning down a new fund from an existing manager in their portfolio.

Brendon Parry, who oversees the private-markets program for asset manager TIFF Investment Management, also has declined to commit more capital to some existing managers for reasons that include personnel turnover, increases in fund or deal sizes, a proliferation of investment strategies at a single firm and reduced transparency, Mr. Parry said.

“I think the message to the GP community is that we can’t take our investors for granted,” said Amyn Hassanally, a partner at Coller.

Although many investors say they are more likely to turn down an existing manager in their portfolio than in the past, plenty of them say they are still adding new relationships to their portfolio even if determining which firm to let into the portfolio is challenging. Almost 58% of survey respondents said they maintained the same pace of building new general partnerships in the last 12 months as they did before the pandemic.

Andrea Auerbach, head of global private investments at Cambridge Associates

PHOTO: SRK HEADSHOT DAY

After a year or more of working from home "I am looking at my closet and literally want to throw it all away and start over," said Andrea Auerbach, head of global private investments at Cambridge Associates. "It's the same with private-equity programs. Many LPs are trying to scale down their relationships and concentrate their capital [to make] room for new names."

However, manager selection has gotten harder for investors, particularly North American investors with 57% of such investors surveyed saying it is a difficult environment for selecting managers.

"Deciding what managers to allocate scarce and valuable capital is never an easy thing," said Mr. Parry. "In the current environment, where there's a vast universe of GPs from which to pick, if LPs don't have a clearly defined strategy and strong viewpoint on private equity, it can be overwhelming."

Many established private-equity firms returned to market sooner than expected during the pandemic and raised their funds fairly quickly, contributing to a high velocity of fundraising, investors say.

"There was no shortage of investment opportunities for LPs, particularly from well-known managers," said Steven Hartt, a principal at consulting firm Meketa Investment Group.

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Investors that normally would have seen around one-third of the existing managers in their portfolios return to market with new funds were suddenly faced with double the number of managers pitching new offerings, according to Ms. Auerbach.

“And, as ever, there is a bumper crop of new managers,” she added.

Despite the challenges of vetting funds in a crowded market, nearly 64% of North American investors surveyed by Coller said they still think it’s a good time to invest in the asset class.

“It is a high-class problem to have a lot of strong opportunities to choose from,” said Meketa’s Mr. Hartt.

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