COMMENT

Fundraising reimagined: Attracting LPs in a post-pandemic world

Tom Carlyle, senior vice president, Private Funds Group and Katya Leonov, vice president, European Distribution, Private Funds Group at Houlihan Lokey discuss LPs' re-emerging appetite for private equity and their new requirements.

At the start of the global pandemic, less than 25% of institutional investors were "open for business," with just over 20% deciding to put investments on hold and the remainder cautiously appraising their options, based on a survey of more than 100 LPs we spoke to across the US, Europe, and Asia.

This reflected much of how the world viewed the economic landscape at the time. However, a recent review of the fundraising market paints a more positive picture. What we see currently, across the world by region and by investor type, is that institutional investors are adopting an investment appetite akin to pre-Covid-19 levels and have maintained their willingness and ability to deploy capital to the asset class; however, this comes with the need for GPs to adopt a more nuanced approach to marketing their funds.

Initially, there was a sense that the denominator effect, i.e., when an investor's private equity allocation grows as a percentage of the portfolio as a result of the diminishing value of public markets, could come into effect with LPs shunning new commitments or selling fund interests in the secondaries market. However, as opposed to the global financial crisis (GFC), this has not materialized, partly due to a rebound in public markets and secondly because investors in private equity have learned lessons from short-termism following the last crisis.

Open for business

Today, LPs continue to invest, citing the potential for GPs to capitalize on the opportunities created by the Covid-19 pandemic. What we have seen from our discussions across North America, Europe, and Asia are that LPs, whether it be pension funds, endowments, foundations, or family offices, are open for business, including those more prone to being risk-averse.

Even in Japan, where traditionally institutional investors are very conservative, capital is still being invested—a very different perspective to the GFC. A recent survey illustrates that 82% of institutional LPs have maintained or increased allocations to the asset class from Q3 2019 to Q3 2020, a fact borne out historically, as periods following a market dislocation have resulted in more attractive valuations, and LPs perceive post-crisis vintages as outperformers and don't want to "miss out" as many did post-GFC. Moreover, most PE portfolios have weathered the Covid-19 storm well, giving LPs further comfort that PE, as part of a strategic allocation to alternatives as an asset class, is a long-term investment that tends to outperform post-crisis. Best put by a European fund of funds: "Our entire team is working from home, but life goes on! We are bullish on the market opportunity."

LPs are rigorously pursuing certain strategies and sectors, with strong demand witnessed for distressed, special situations, healthcare, and software funds.

Furthermore, as the pandemic brought policy matters such as climate change, diversity, and social justice to the limelight, investors have given more time and consideration to an increased ESG/CSR focus, a feature which we see as a permanent development. Another feature that we see in evidence is that re-ups are becoming a defining trend of this period, as LPs are more comfortable deploying capital to those GPs they know well and have met in person.

Attracting investors

Therefore, what can GPs do to attract new LPs in a post-pandemic world? The key consideration is determining the right time to market. In our experience, coming to the table too early can be a momentum killer for a fundraise. In the bull market leading up to the pandemic, GPs began soliciting investor interest with less than 50% of their previous fund committed. While previously viewed as a point of frustration for LPs, this has now become a non-starter post-pandemic. "Come back to us when you have more deals under your belt" is the new normal response. For first-time funds and spinouts, we have seen that executing a pre-fund deal to demonstrate that the new model works has been a successful strategy in attracting LPs.

In practical terms, the lack of physical face-to-face meetings has not been a deal breaker but rather a hindrance to establishing the relationship, so our view is that there are certain protocols that need to be undertaken. Virtual diligence sessions should be shorter and more efficient—perhaps split over a number of days. Subject to Covid-19 restrictions, the GP should ideally appear together in the office to give a greater sense of team. Where permitted, it pays to get creative. We have seen takeaway coffees in the park and picnic table meetings sealing commitments. With the lack of personal touch, LPs are increasingly relying on referencing as part of the new virtual diligence world, meaning polishing and updating the reference list should be a priority.

Now more than ever, AGMs (and AGM recordings) can serve as an effective follow-up and diligence tool for new LPs. Virtual AGMs need to be concise, engaging, and ideally no more than three hours. Helping to position a GP's insight and capabilities is essential, and outside speakers, panel discussions, and interviews work well in capturing LPs' attention for extended periods on the screen.

In summary, private funds are still attracting capital. By adopting a bespoke tool kit, GPs can effectively navigate the "new normal," maximise their capital, and minimise time in market. Even with a vaccine and a renewed ability to travel, it is unlikely to be the end of Zoom meetings, with LPs expected to utilise technology to narrow down the funnel of the burgeoning opportunities in the market. Simply, those GPs that continue with their old ways will no doubt hit obstacles in a post-Covid-19 world. ●