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The Adveq Applied Research Series

A research series by the Private Equity Institute at London Business School

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What you pay and what you get... The evolution of fund terms, fundraising, and returns in private equity

The private equity industry has evolved rapidly over its relatively short history mirroring the increasingly complex relationships between General Partners (GP) and Limited Partners (LP).

Historically the industry has shown remarkable resilience when it comes to changing the fees that investors pay to managers. The terms on how GPs and LPs connect have changed, but have the fee structures evolved too?

Is the industry broadly sticking to the 2/20 fee model or are some actors adopting contrary positions? If variances exist, are these also impacting fundraising and performance?

The latest paper from the Adveq Applied Research Series aims to answer these questions and more.

Dear reader,

We are pleased to share with you the latest Adveq Applied Research Series paper titled "What you pay and what you get… The evolution of fund terms, fundraising, and returns in private equity". Researchers from the London Business School have tapped into Preqin's fund term and performance data, to develop a database of 1,748 unique funds belonging to 1,134 private equity firms for the period between 1998 and 2015. By linking these two sets of data, they have analysed how changes to fund terms have impacted performance and fundraising.

The report confirms that past performance is never a guide to the future and that it also does not justify higher carry levels either. When making investment decisions, LPs take into account factors beyond performance and judge each opportunity individually.

A changing relationship

One of the main highlights of the research paper is the increase in separately managed accounts and co-investments, reflecting the evolution of the LP-GP relationship.

The need to balance the search for yield and specific investor requirements are fuelling these now more common private equity relationships, which focus on customised mandates. As these arrangements tend to be discretionary, so do the associated terms.

Despite calls for higher transparency, the increase in separately managed accounts coincides with an industry move towards disclosing fewer details, making it more difficult to say how these fund terms deviate from the wider sector.

Does size matter?

The report finds that fund size strongly correlates with fund fees – larger funds tend to charge less. Funds do not seem to trade management and performance fees off. Where management fees are higher, carry tends to be higher and in certain cases the hurdle is lower. While one might expect that funds offer various fee packages in an attempt to differentiate their offering, the report finds that funds are either cheap or expensive.

The report shows that size and fund lifespan play an interesting role in fund-raising. Larger funds seem to receive more funding than they originally anticipated and funds with longer investment periods, more than five years, seem to fall short of their initial funding targets.

While a deeper dive into the data shows that small discounts, could shorten fundraising periods, bigger discounts are not seen positively. In addition, unusually low carry makes investors suspicious and fundraising harder.

Are listed funds better?

The study also looked closely at funds offered by publicly listed private equity firms and found a strong correlation between being listed and performance success –some of the better funds in the research were found to be listed GPs.

However, the research reveals that while funds of firms about to be listed or shortly after tend to perform better, the performance tends to face off after the firms go public. The report is not conclusive on why that is the case, but raises the argument that the growth of publicly listed firms may come at the expense of performance. Once listed, funds need to respond to market demands by analysts and investors and often decide to extend to more and less profitable asset classes.

We hope you find the report and its conclusions interesting and that they prove to be a helpful aid in understanding the industry dynamics.

As always, we welcome your views on the report and thank-you for your interest in Adveq, the London Business School, and the work we are collectively undertaking to improve the understanding of key aspects of the private equity market.

Adveq, June 2017

About Adveq

Founded in 1997, Adveq is a leading asset manager investing in private equity globally. Adveq invests in all private equity strategies, including venture capital, growth capital, buyout, and turnarounds through primaries, secondaries, and direct/co-investments.

Adveq's client base comprises institutional investors such as pension funds, insurance companies, endowments, family offices, and other financial institutions located in Europe, North America, and the Asia-Pacific region. For its clients Adveq is a long-term partner for investments in private equity.

Adveq has offices in Zurich, Frankfurt, London, Jersey, New York, Beijing, and Hong Kong.

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