VC-PE Index
Are LPs Really Consolidating Relationships?

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"We are seeing LPs increasingly wanting to consolidate their providers... And so we're seeing definitely a trend towards the big providers—the big LPs—wanting to consolidate capital with the big managers like us."

- TONY JAMES, APRIL 20, 2017, Q1, 2017, EARNINGS CALL

We have seen and heard different variations of Tony James' anecdote from a number of clients and large LPs like Hamilton Lane. To help GPs better understand the breadth of this trend across the LP landscape, we dug into our dataset to get an in-depth understanding of the actual numbers.

What we found confirmed that consolidation is happening. One of the consequences of this trend has been that LPs have gravitated towards larger managers while being more selective when it comes to emerging managers.

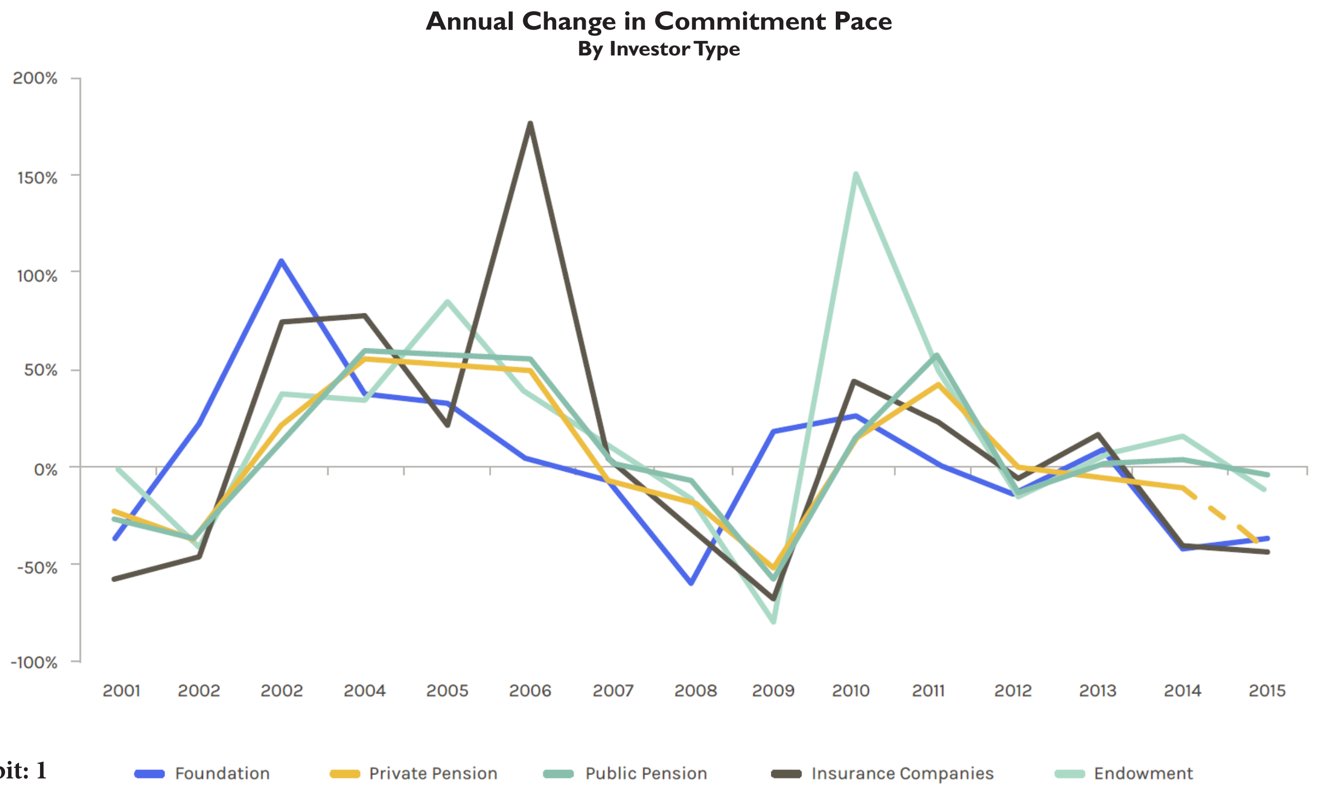

Exhibit: 1

LPs are Investing with Fewer Managers

We started by looking at the pace of commitments to see if the trend of consolidation was reflected in the numbers. As we described in our last thought piece,* fundraising markets are in the midst of a six year hot streak. In spite of this, the chart below illustrates that major segments of the LP market have been taking a slow and steady approach.

The final tally is not in yet for 2016 but we anticipate it will be the third consecutive year where we see a year-over-year decline in the number of commitments. To dig deeper and understand whether fewer commitments has meant these LPs are committing less to private equity, we analyzed how much public pensions have been committing annually.

The number of commitments made by public pensions was slightly positive in 2013 and 2014 before dipping in 2015. Despite the modest peaks and valleys in the commitment pace, the amount being committed to private equity has steadily increased since the market's recoil in 2009. What the chart above highlights, however, is that their steady increase has not kept pace with overall market's growth.

This confirms that, at least among public pensions, LPs are investing more capital with fewer managers. Knowing that a sizeable segment of the LP universe is investing more dollars with fewer managers, we wanted to understand who were the winners and losers in this consolidation trend.

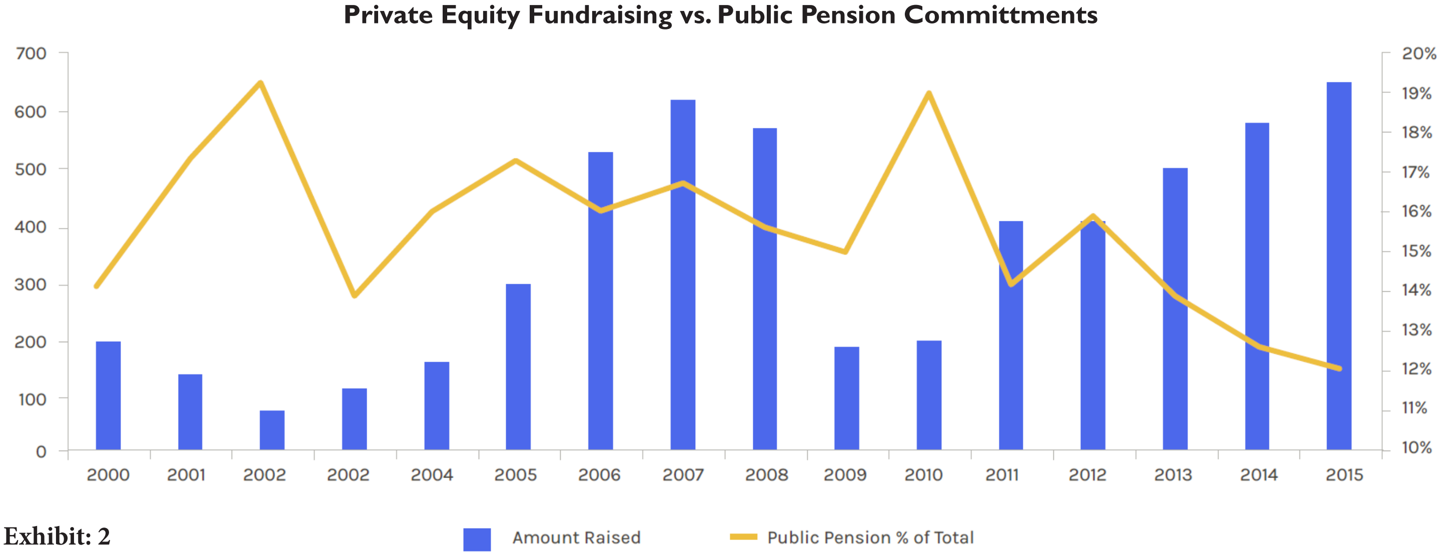

Exhibit: 2

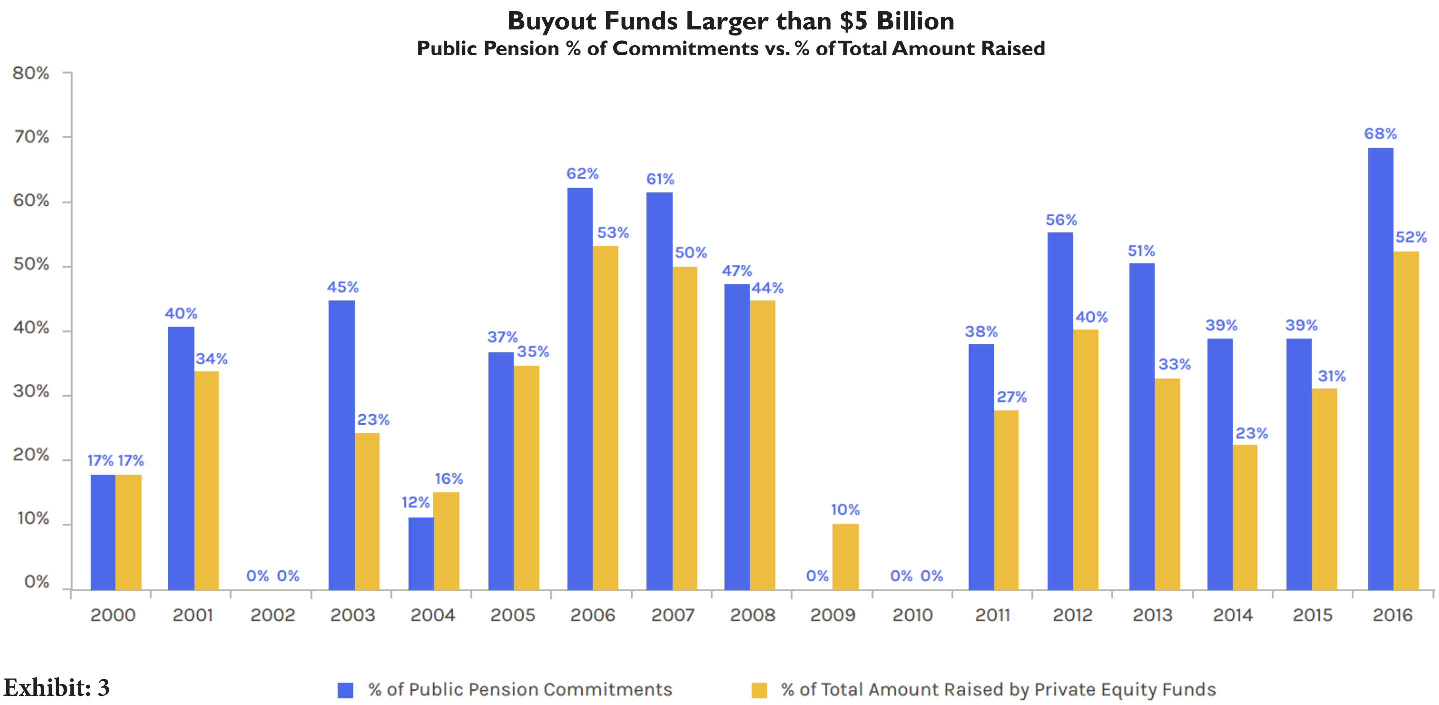

Exhibit: 3

Larger GPs Are Benefitting from the Consolidation Trend

The number of record-breaking fundraises is something that gets well documented during periods of fundraising strength. The news of Apollo IX's record-breaking $23.5 billion, CVC's record-breaking (for a European-based manager) €16 billion, and KKR Asia's record-breaking $9.3 billion fundraises proves that this period is no different.

Looking at commitment information for public pension funds underscores the degree to which large buyout funds dominated the market in 2016. As the chart below indicates, public pension funds have generally trended towards being overweight in larger funds in comparison to the larger funds' representation of the entire market.

However, the level to which large firms crowded out the rest of the market in 2016 reached new heights. Just 13 funds (10% of funds) represented 52% of the approximately $230 billion raised by buyout funds. Meanwhile, public pensions invested more than $42 billion into buyout funds in 2016, 68% of which went to managers

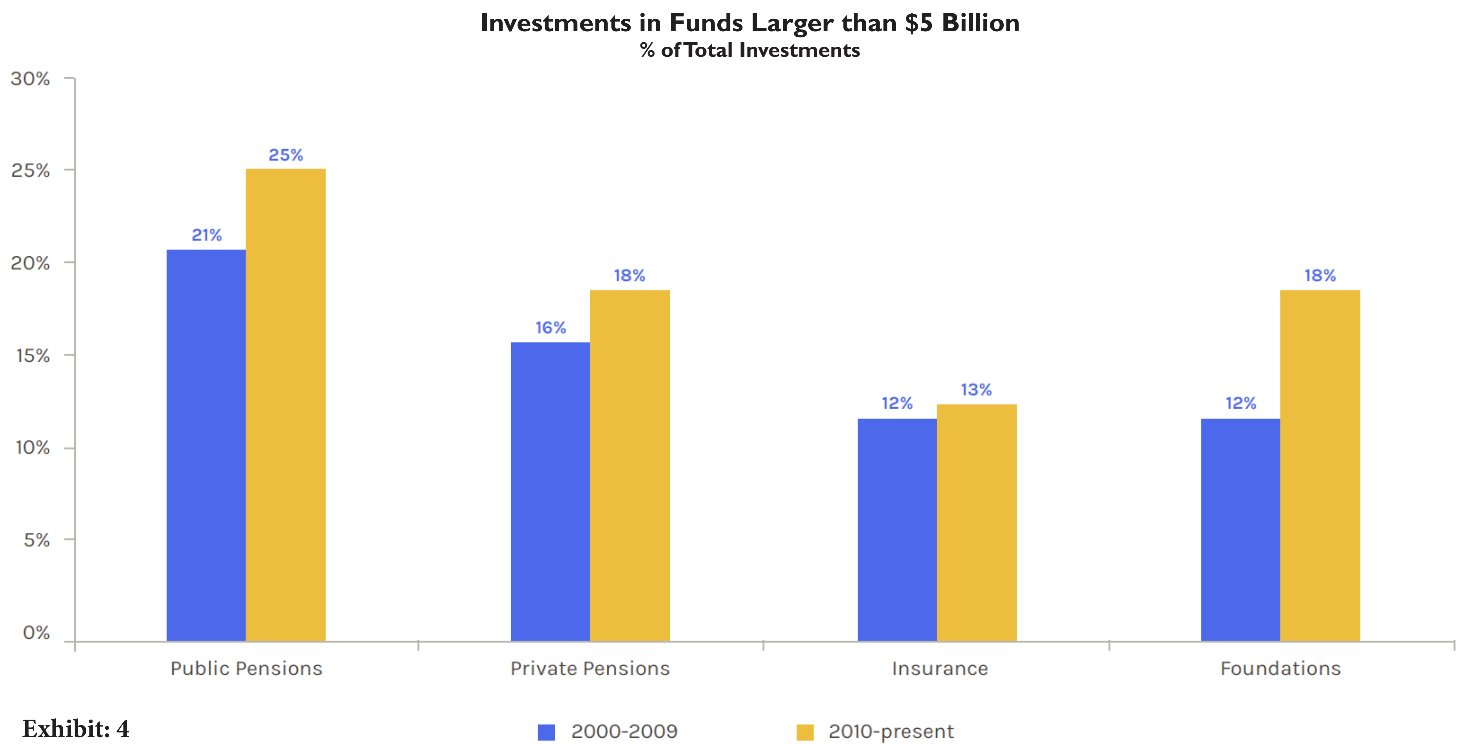

Exhibit: 4

As the chart above illustrates, larger managers appear to be having success increasing allocation across all the major LP types.

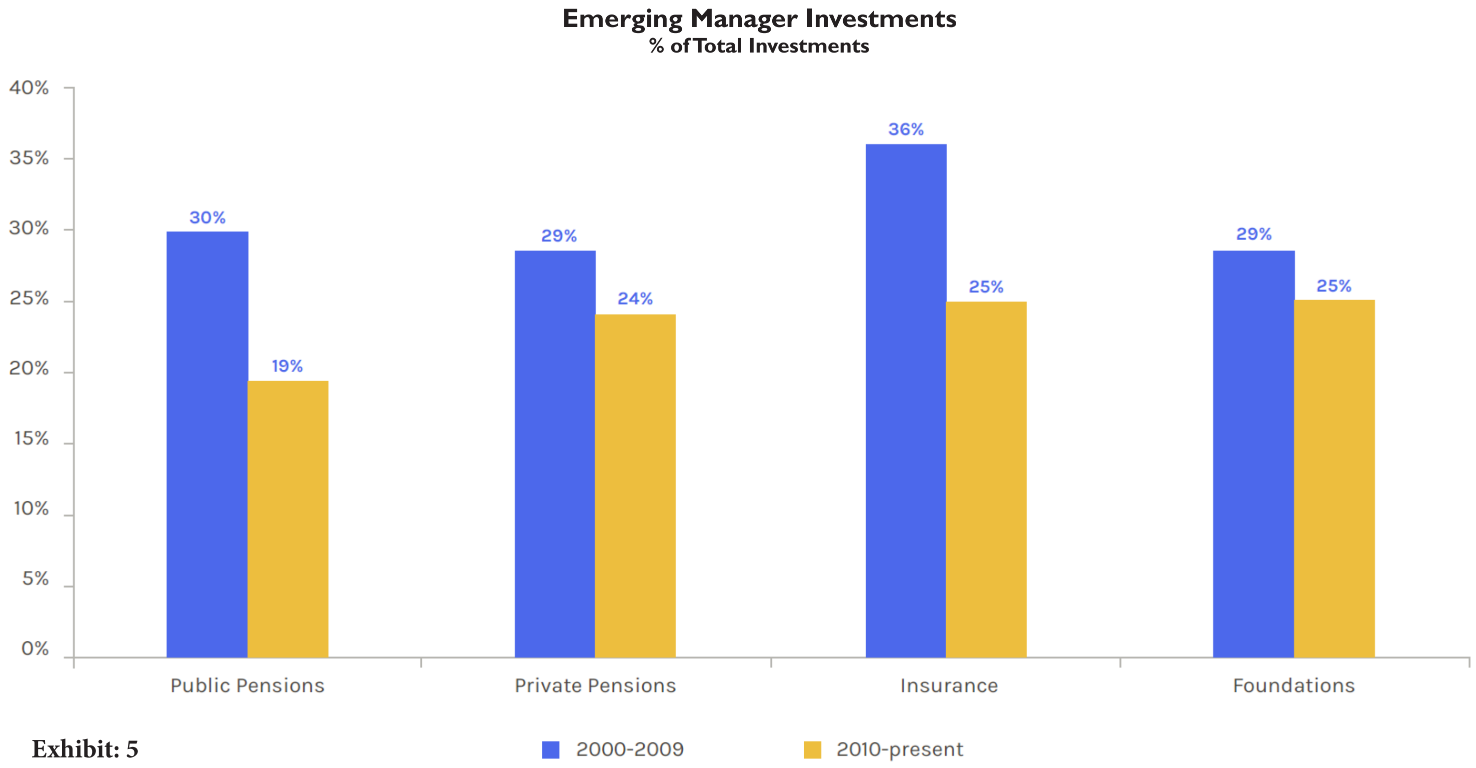

Exhibit: 5

that raised a fund larger than $5 billion. This easily surpassed the allocation percentages to larger funds last seen in 2006 and 2007.

If we cut the data by number of investments, we see that the positive trend in the amount committed by public pensions to larger funds does carry over to the number of investments as well.

Emerging Managers Are Faced With More Selective LPs

Private equity is a constantly evolving industry filled with highly-motivated, entrepreneurial- minded professionals that dream of charting their own course and putting out their own shingle. Their success at starting their own firms will depend heavily on finding a few cornerstone investors willing to take a chance on a new, highly motivated team. Based on what the data shows for large funds, one could anticipate what the emerging manager data would show.

As the chart above indicates, emerging managers had an easier time securing commitments in the previous decade than they are having in the current decade. From 2000 - 2009, the average LP invested in emerging managers 30% of the time. From 2010 to now, that average has fallen to 22% across the entire LP universe. As LPs shifted towards a model of allocating more money to fewer managers, LPs started to be more selective about whom among the next generation of firms they want to support.

Wrapping Up

When we looked at the market from the LP perspective, we saw an overly crowded market but more GPs were raising more money. While a rising tide generally lifts all boats, we wanted to dig into what LPs in our dataset were doing and understand who were the winners and losers of this era. What we found confirmed many of the anecdotes that we have heard from GPs and LPs that we work with. Namely, that a large portion of the LP market is being much more selective about how they allocate capital. Larger GPs have done a good job over the last few years absorbing these fewer, but larger, commitments. On the other hand, this has meant that newer GPs have had to work harder to separate themselves from the crowded field seeking LP attention. These GPs need to make sure they truly understand what makes them unique and how that value proposition matches up to what each LP is looking for.

*https://www.cobaltgp.com/private-markets-bubble-golden-age/

Author Bio

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Mike Roth is the Research Manager at Bison and oversees the data collection and content production. Before Bison, Mike spent six years on the investment team at SVG Advisers. There, he conducted research and due diligence on buyout and venture capital funds in the Americas. Mike received his BA in Economics from Boston College and is a CFA Level III candidate.