"What I Wish I Knew"—*Hiring My First Placement Agent*

Yasin Ebrahim

Yasin Ebrahim
is a senior associate at Constantine Advisors in London, UK.
yebrahim@constantineadvisors.com

Fundraising statistics released by Preqin for 2013 provide evidence of the continued growth of private equity, as the industry raised the largest amount of capital since the global financial crisis, totaling $431 billion, which is a 13% increase over the levels in 2012.

Initially, capital for private equity originated from individual investors or corporations. As private equity evolved, it became an asset class in which various institutional investors, including pension plans, universities, insurance companies, foundations, endowments, and high-net-worth individuals, allocated capital. These investors are referred to as "limited partners" (LPs) in the fund. Private equity fund managers, referred to as "general partners" (GPs), hire placement agents as external marketers to "sell" the fund to prospective investors.

Placement agents are gatekeepers to all types of LPs and in some instances have also cultivated excellent relationships with development finance institutions (DFIs), such as International Finance Corporation (IFC), CDC group, and African Development Bank (ADB), for example.

Should a GP Adopt a "Do It Yourself" Approach?

Hiring a placement agent is not an option for all PE fund managers—established private equity funds with a profitable track record that extends several years, a solid global investor base, and a robust internal sales team are less likely to obtain the services of a placement agent in order to market their funds.

Time is a critical resource in any business—a PE fund manager devoting more time to the fundraising process has less time to focus on implementing the fund's investment strategy. Placement agents have a broader investor reach than most managers can attain without a large internal sales force. More importantly, the investment universe is quite diverse; it is plausible that a prospective investor may not be familiar with a particular asset class, investment focus, or strategy, therefore, the education process is often time intensive. Placement agents are in frequent dialogue with LPs and stay abreast of the ever-changing investment interests and objectives of these potential investors.

A placement agent usually has the relevant private equity buy-side and sell-side industry experience required to understand the PE fund manager's investment strategy and objectives. The presence of industry experience will expedite the marketing process, as the placement agent is better equipped to both shortlist suitable prospective investors and translate the strategy to prospective investors effectively. Consequently, prospective investors are more receptive to considering potential opportunities put forward by the agent.

This process is invaluable to GPs, according to Fraser Van Rensburg of Asante Capital, "A placement agent needs to craft their client's message in a way that defines what they are doing that clearly differentiates them. If you give an LP even the slightest reason to say no, they will say no. This is a first impressions game."[1]

Fast Track Opportunities for Investors

In a world, where investment opportunities are abundant, the process of distinguishing opportunities with tangible outcomes and managers capable of executing the proposed strategies can be challenging for investors. It is rare for an investor to possess expert knowledge of every aspect of the investment universe; accordingly, there are certain fund opportunities that investors may not consider if they lack sufficient understanding of the strategy.

Placement agents expand the range of investment opportunities that are available to prospective investors, as they conduct due diligence on the fund principals' track record, investment strategy, and other important criteria. Based on their findings, placement agents will select a few of the best and most relevant investment opportunities for investors to consider.

PE investors, similarly to other investors, seek a positive return on capital invested. However, the majority of private equity funds function on a long time horizon, requiring approximately 5–7 years until investors can begin to realize returns. Therefore, the performance of the fund on exit has to compensate for the opportunity cost created by a lengthy lock-up period. Consequently, finding funds with a marketable story—an excellent track record, significant assets under management (AUM), managerial expertise, and sufficient target fund size—is of utmost importance for placement agents when preparing to introduce PE funds to investors. A marketable story is more easily translated in clear terms and increases the GP's chances of receiving capital commitments.

SECURE THE "ANCHOR" TO ATTRACT THE AGENT

The larger placement agents usually work on six to ten fundraising mandates per year, therefore, they prefer to undertake mandates that represent the "low hanging fruit"—a private equity firm with an easily marketable fundraising effort in place. Private equity funds seeking to raise capital for the first time will often not meet the requirements of a marketable story, because their lack of a track record, insignificant AUM, and limited target fund size will discourage placement agents from considering it as a viable opportunity.

Being an investor in a first-time fund carries a risk, which is amplified when the investor in the fund is the first LP to come on board. The usual comfort an investor would derive in the knowledge that other investors have committed capital (due to the fact that they believe in the manager and strategy) does not exist, nor is there a track record to alleviate the fear that the manager will fail to execute the strategy successfully. However, the ability of a first-time fund to secure a reputable placement agent is greatly improved with the existence of an anchor investor. An anchor investor is usually a well-known institution, sovereign wealth fund, or, in some cases, a celebrity. This type of investor will typically commit a large portion of capital in the fund and the fund will be able to draw on the anchor investor's network and expertise. These dynamics will help to build fundraising momentum as the perceived risk is reduced in the eyes of other investors.

CHOOSING BETWEEN THE "FULL SERVICE" OR BESPOKE AGENT

A crucial decision for a private equity GP who is considering hiring a placement agent is the cost. The cost of hiring an agent depends largely on the level of involvement and amount of heavy lifting required by the agent. The level of involvement is dependent on the magnitude of investor demand for the investment opportunity, the GP's experience, and the specific fundraising requirements.

A GP deciding to hire a placement agent and offer exclusivity over a fundraising mandate can expect the placement agent to adopt a "full service" approach. A full service approach involves more handholding from a placement agent and may involve assistance with preparing due diligence materials, drafting of the private placement memorandum (PPM), and helping the GP to better understand key target markets. Commonly, the larger placement agents are equipped to offer a full-service approach that relies on their extensive in-house capabilities, as well as global investor reach.

A placement agent would prefer to have input on the production of marketing materials, as they are able to use their intimate knowledge of their investors' preferences in order to "package" the fund appropriately. This view is shared by Leighton Matheson of UBS, "We have been in the private equity placement business for 15 years and typically work on 10–12 funds globally at any one point in time. As a consequence, we understand what investors want, so in some cases are actually better positioned than the GP when it comes to compiling materials."[2]

Once the fund is investor ready—all marketing and due diligence materials have been completed—the fund manager is ready to hit the road and engage with potential investors.

The placement agent will usually take the lead on the road show, targeting which regions and investors to engage with first. The agent will secure meetings with potential investors and may coach the GPs prior to those meetings to ensure that the GPs will articulate their strategy confidently and coherently when pitching to potential investors. However, this process is easier since the placement agent will have warmed up the investor prior to the meeting.

During the meetings, the placement agent can serve as a liaison by smoothing exchanges between the GP and potential investor(s), allowing a common ground to be established more quickly. Once the meetings have concluded, the placement agent is responsible for all investor relationship communications, keeping both the GP and potential investor(s) abreast of developments.

It is evident that this approach requires a high level of involvement, which GPs should take into account when deciding on a marketing budget; the cost of a full service agent will be higher and requires both a retainer and a success fee.

A success fee is expressed as a percentage (usually 2%) of the capital committed from the investors that are introduced to the GP by the placement agent. A retainer is a fixed monthly fee paid upfront to secure the services of the agent and usually comes in two forms: retainer fees that are offset against success fees and retainer fees that are not. Placement agents prefer to include a retainer fee, as it helps cement commitment from both sides.

GPs that are investor ready, with significant fundraising experience may not require a full service agent and may choose instead to hire a placement agent on a bespoke fundraising mandate. The placement agent can be contracted on a "names basis", where the agent will provide the GP with a list of qualified investor leads and expert advice, however, he or she may not make a personal introduction and the responsibility to contact the leads remains solely with the GP.

Another option for GPs involves contracting a placement agent to secure investors from a particular region for the remainder of the target fund raise. For example, a fund manager with investor commitments of \$400 million from Asia and a target fundraise of \$500 million could hire a placement agent to secure the remaining \$100 million of the target fundraise from investors based in Europe.

The cost of contracting a placement agent on a bespoke fundraising mandate would be significantly lower than it is on an exclusive mandate. However, reputable placement agents take on a limited number of fundraising mandates a year and therefore they are less inclined to work on limited mandates, unless the opportunity is particularly attractive or fills a gap in their marketing pipeline.

TO AGENT OR NOT TO AGENT

Recently, placement agents have not only endured negative headlines from the press, but also from fund managers, who claim that placement agents are nothing more than walking Rolodexes, seeking to feed on the aspirations of fund managers who are desperate to secure investor commitments. Nevertheless, GPs cannot escape the fact that pitching to uninitiated investors is a challenge and using a suitable placement agent can be an effective and efficient way for fund managers to reach interested parties, allowing managers to focus less time on the fundraising efforts and devote more resources to managing their funds.

Certainly, a fund manager hiring a placement agent should not adopt a cursory approach to evaluating a placement agent, but rather should conduct thorough due diligence on the placement agent, just as he or she would on developing a new investment strategy. The fund manager's confidence in a placement agent should originate from an aligned interest with the placement agent. This involves ensuring that the placement agent is familiar with the investment strategy of the fund and possesses the expertise necessary to engage potential investors who are most likely to be receptive to the strategy.

Furthermore, the fund manager must confirm that the placement agent has a successful track record in raising funds with similar mandates, thus limiting the market risk of the fundraising effort.

It is no surprise that recently the largest target fundraises, such as EIG Global Energy Partners, which raised $6 billion of LP commitments, opted to use a placement agent to secure the capital commitments. This collaboration resulted in a shorter marketing timeline for the firm.

Even the best of strategies requires a good story to win the hearts and minds of investors, therefore, who better to leave it to than the man in the middle, if he is knowledgeable and has strong connections to the investor community?

As long as GPs ensure that their chosen placement agent is capable of accomplishing the fundraising objectives of the fund, the chances are good that all parties will be satisfied with the outcome, perhaps even bringing the GPs closer to being over-subscribed, the most coveted fundraising status in the world of private equity investments.

ENDNOTES

[1]Source: Keynote Interview: Asante Capital Group, "The Story-Tellers." *Private Equity International.* November 28, 2013. Retrieved from http://asantecapital.co.uk/pdfs/PEI_Sup_Persp_Asante.pdf.

[2]Source: T. Burroughs. "Man in the Middle: Placement Agents in Asia." *Asian Venture Capital Journal.* May 9, 2012. Retrieved from http://www.avcj.com/avcj/analysis/2173317/middle-placement-agents-asia.