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What to expect from a placement agent: things you should know

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The basic role of a placement agent is obvious – to raise capital for its fund manager clients as expeditiously as possible. How that role is executed, however, varies greatly from agent to agent, and can vary by client as well. In addition, the fundraising market is changing dramatically as private equity both becomes a more established asset class and comes under stress in the current economic environment. This chapter provides a broad overview of the value that a placement agent offers, as well as insights into developments in the fundraising market.

The roles placement agents play

Placement agents can serve in a number of different capacities depending upon how early they are brought into the process and how much the fund manager intends to rely on them. Newer fund managers in the process of launching their first fund often rely on placement agents for the full suite of services explained below, while more experienced fund managers with several vehicles under their belt use agents tactically for narrowly specific purposes – if they use them at all. The basic roles that agents play are summarised below.

The Rolodex and the travel agent

All placement agents introduce fund managers to investors. A number of people believe that is their sole function – to be, essentially, a glorified Rolodex of investors. The least sophisticated agents, with minimal market knowledge and stale or weak contacts, are probably just that. The best placement agents, however, are interactive databases, tracking the shifts of personnel at institutional investors, as well as changes in sector appetite, investment processes and private equity allocations at the investors they cover. Quality fund managers hire agents to make their fundraising process more efficient. They seek not just to meet investors but to target qualified investors who are actively seeking exposure to their investment strategy. A constantly updated perspective on who is buying what – and the internal processes one needs to go through to get to a commitment – is critical for efficient fundraising. The foundation for this insight is a strong set of investor relationships, usually built upon long-standing personal interactions, that permit a quality agent to develop a focused and strategic marketing plan, not just a series of road shows.

Along with the Rolodex role goes acting as a travel agent – putting together road shows as efficiently as possible. Private equity fund sales are not driven simply by receiving a Private Placement Memorandum (PPM); most institutional investors want to meet personally with senior managers of the general partner, and the first meeting is usually held in their offices. Given the importance of public pensions and sovereign wealth funds to the market, any broad-based fundraising results in extensive travel, often to such off-the-beaten path locations as Bismarck in North Dakota, Brunei or Helsinki.

The communications consultant

Most placement agents assist fund managers with their marketing material in order to present a consistent message as part of a coordinated marketing strategy. Successful agents are repositories of a tremendous amount of experience; they know specifically what has worked, and perhaps more importantly what has not worked, in the past for other managers and can help refine how a story is told.

The two most important documents in this process are the PPM and the presentation deck. The PPM is of course a legal document that at the end of the day must be signed-off on by the fund's attorney. But it also needs to present a convincing case for an investor to commit to a fund, and stand out in some way from the large number of PPMs that institutional investors receive. Many investors won't schedule a meeting with a fund manager until they have received and reviewed a PPM, and it is a key gating item in the sales process. The executive summary of the PPM must make the investment case clearly and succinctly in the midst of disclosures of risk, and in its final form is usually the result of long negotiation between the agent, the fund formation attorney, and the fund manager. It also needs to avoid the use of terms that may be misunderstood by investors and that may inadvertently generate hostile reactions.

While the PPM is usually the first written communication an investor receives as part of the sales process, the presentation deck (usually taking the form of a PowerPoint or similar presentation) serves as the framework for the first in-person meeting with an investor. It also needs succinctly and convincingly to lay out the investment opportunity, timed to the 45 to 60 minutes usually set aside for first meetings, and as a personal presentation it must be practiced and polished before going on the road. A good placement agent not only assists drafting the deck, but also helps select the best representatives of the fund manager's team to go on the road, and directs practice sessions. Especially with newer funds, managers usually have a lot of experience with the investment process but are actually very inexperienced in explaining their strategy and value proposition to investors. Focusing on the dynamics of actually making a presentation is key, as the impression that a fund manager makes during the initial ten to 15 minutes of this first meeting is often indelible, and sets investor expectations (and their willingness to engage) from that point onwards.

The strategist

If engaged early in the process, an experienced placement agent can act as a strategic adviser, especially to a new or emerging manager who, while often an accomplished investor, may be inexperienced in fundraising or establishing an investment management firm. An agent can provide key insight on such issues as the target fund size, investor expectations of the staffing levels and professional backgrounds needed at fund at its launch, the process of negotiating track record attribution issues with previous employers, and the selection of a fund formation attorney. Although this strategic advice might be less important for an experienced and stable fund manager looking to raise a Fund VI or VII, it can be of inestimable value to a established manager in the midst of dealing with staff turnover or succession issues, or to one seeking independence from a well-established sponsor.

As far as marketing strategy *per se*, regardless of its stage of life, a fund manager can benefit from the strategic advice of an experienced placement agent regarding the construction of a robust, diversified and scalable base of investors as part of the fundraising process. This expertise ranges from identifying potential lead investors – well respected either globally or within specific geographies – who are willing to commit early and take a leading role in negotiating documents, to determining the proper timing for launching a fund, to handicapping the likelihood and level of returning investor commitments. In difficult markets such as the present, the question often becomes not the willingness of an investor to commit to a fund manager with whom they have a relationship, but their ability to do so. Very often an experienced agent in frequent contact with investors has a better feel for these issues than a fund manager does.

In fundraising, momentum matters: the longer a fund is in the market without a significant close, the more investors consider it unimportant or a failure, either rejecting it completely or pushing it to the bottom of their ever-increasing pile of opportunities. Strategy in fundraising consists of putting together a marketing plan specific to a fund that drives investor interest to a quick close – though the definition of 'quick' often depends upon the overall tenor of the market. While quick in 2006 may have meant three to six months, in 2009 quick is more likely to mean 12 to 18 months.

The negotiator

Experienced placement agents often will advise a fund manager on fund terms and conditions before the fund goes to market, to help ensure that the terms are within market – or close enough not to cause investors to reject a fund out of hand on first receipt of a PPM. Most managers raise a new private equity vehicle only once every three to five years. Between fundraisings, they focus on investing the money raised rather than keeping in touch with fundraising market trends. Certain key issues – most especially 'standard' terms and conditions such as management fees, distribution waterfalls and 'no-fault divorce', key-man or clawback provisions – change in importance over time; the definition of 'market terms' is constantly in flux. Given their regular interaction with investors, placement agents can offer timely and reliable insight on how investors will react, not only to individual terms but also to the entire package of economic and governance provisions. Launching a fund raise with terms closely aligned to the market is essential for success today, since sophisticated investors are increasingly unwilling to pursue even very strong investment proposals that are improperly structured.

Once the actual negotiation process begins, an agent can also be helpful in putting investor demands in perspective. Through independent conversations with potential investors (as well as its knowledge of recent past negotiations on other funds) the agent can often highlight the most contentious clauses – the hot buttons in the process – and can also suggest which compromises or package of terms will lead to the best conclusion, depending upon which terms are most crucial for the fund manager.

Split mandates, 'top-offs' and restarts

The complete description above of the roles an agent plays makes one large underlying assumption: that only one agent is involved in the process and is involved in a fundraise from its inception. Most agents prefer to operate as the sole marketing representative of a fund, and many of them want to be involved early in a process so that they can help craft a story. But agents can be asked to participate in different ways:

- *Split mandates:* Split mandates usually occur when a fund manager seeks specific geographical expertise and believes that a combination of agents is more effective than a single agent alone. Even in this instance, one agent usually takes the lead role and provides strategic advice globally, while the other agent provides the Rolodex function for a specific geography. The process of managing a split mandate can be frictional and time consuming as it is crucial to present a single front to the market instead of an uncoordinated mess with various parties tripping over each other in front of investors. Many larger agents are reluctant to participate in split mandates for this reason.
- *'Top-offs':* Well-known fund managers raising follow-on vehicles with strong investor support may bring in an agent simply for its relationships with a certain type of investor or in a specific geography, usually for a very minor portion of the total raise. In effect, the agent is brought in as part of a split mandate in which the fund manager itself acts as the primary agent, directing everything itself except for the small portion carved out for the external agent.
- *Restarts:* At times, fund managers decide that they do not need the services of an agent, launch a fund into the market – and find out that they are wrong. They then circle back and try to restart the process in the middle of fundraising, looking for an agent to assist. The problem is that there is only one chance to make a first impression, and a fund manager who has already widely approached the market with its story has set that impression. Placement agents are not magicians, and most are reluctant to participate in a restart which, almost by definition, has no momentum.

Types of agents

One of the reasons that split mandates exist is that agents differ tremendously in their size, their level of experience, and their geographic scope. They break down very roughly into three categories:

- *Investment bank agents:* Operating as divisions of large investment banks which offer a range of products, these firms – such as Credit Suisse, Lazard and UBS – are global players operating from multiple

offices with large dedicated staffs. Many of the first placement agents were founded in this manner, growing and expanding as the private equity market grew. The current turmoil in the financial markets has affected a few of these agents, not necessarily through any fault of their own but because of problems at their parent – such as happened at Bear Stearns and Merrill Lynch.

- *Global independent firms:* There are also a number of large, global independent firms – such as Atlantic Pacific, MVision and Probitas Partners – that focus solely on alternative investment placement and advisory services. The largest of these firms have dedicated staffs of similar size to the investment banking firm divisions, a global presence, and no 'parent' to siphon their profits.
- *Niche independents:* These smaller firms – sometimes as small as a single individual – often focus on a small circle of relationships, often geographically focused but in other instances focused on expertise with a certain type of fund, such as venture capital or funds of funds. Especially in difficult fundraising markets like the Middle East or Japan, certain of these agents have a competitive advantage because of their specific strong relationships, and they are more likely to be used in split mandates because of those relationships.

In addition to these categories, most professional placement agents are registered with appropriate regulatory agencies, such as the Securities and Exchange Commission (SEC) in the US or the Financial Services Authority (FSA) in the UK. There is a set of rules that agents must comply with in most jurisdictions, and in the US, for example, they must be registered as broker or dealers. A fund manager who deals with an unregistered agent, unfamiliar with the relevant private placement regulations in a market, may be making a serious error.

'Friends-and-family' fundraisings

Many placement agents have a minimum size of transaction they are willing to work on. The time involved, especially in providing strategic advice, is similar whether a fund is targeted at $100 million or $1 billion, but the revenue potential is radically different. In addition, funds that are seeking less than $100 million or €75 million are not usually considered institutional in nature as most institutional investors feel that they are too small to support. These funds are raised on a 'friends-and-family' basis, with the fund manager reaching out to wealthy individuals or smaller institutions whom he already knows, and who are prepared to make an investment on the basis of that relationship.

A placement agent cannot be of much help on a 'friends-and-family' fundraise that is dependent for its success on relationships that a fund manager already has.

The role of secondaries in the fundraising process

As the private equity market has matured, secondary sales of partnership positions have become more commonplace, with certain investors looking to rebalance their portfolio exposures, adjust their funding demands, or exit the private equity business entirely. Prudent fund managers, aware of investors looking to sell positions in their funds, are taking a more proactive role in using the sale of those positions to build relationships with targeted investors whom they would like to attract to their next fund.

Few placement agents have a dedicated and sophisticated practice in the secondary market. Firms with a strong background in both the primary and the secondary market can use the secondary sales process to jump start the process of raising a fund through a 'primary secondary'. In a primary secondary, an arrangement is made between a potential seller and the fund manager such that a buyer of the secondary position not only commits to its purchase but also agrees to commit a specified amount to a new fund that fund manager is about to raise. Such an arrangement is most effective early in the process of raising a fund, where commitments secured can be used to boost the size of a fund's first close and develop momentum. The buyers of primary secondaries are most often funds of funds (that have active primary and secondary programmes) as well as certain primary players looking to establish strategic relationships with certain fund managers. Specialised secondary funds sometimes participate in

these processes, but making primary commitments to funds is not their core investment strategy, and they are unlikely to participate in future fundraisings, developing a long-term relationship in the same way that a fund of funds or a primary investor would.

Fee for services and alignment of interests

Given the wide range of potential roles and added value that placement agents offer a fund manager, on what basis are placement agents paid? This aspect of fundraising is evolving as well.

Standard compensation for a placement agent has historically been a fee calculated as a percentage of new money raised, usually 2 percent to 2.5 percent. But a more sophisticated pricing regime is emerging as the market matures. Established fund managers often seek more selective assistance with current investor relationships, especially where staff at an institutional investor has recently changed or where key consultants represent both current and potential investors. In these instances, a blended fee may be agreed. This provides a balanced incentive for the agent to help with both current and new investors alike, as needed for the benefit of building momentum in the fundraise, whilst it is calculated to take into account the more limited value added by the agent in respect of existing accounts. In addition, the fee schedule may also be tiered by an increased success fee for amounts raised above the target amount.

In most instances, the fee is paid in cash, usually financed over a period of one to two years. Today, some agents take a portion of their fee as an investment in the fund being raised, effectively rolling over a portion of their cash compensation into the fund. Even fewer do so as a matter of policy across all funds that they raise. This tactic, however, benefits both investors and fund managers alike:

- By taking an interest in the fund, the agent more closely aligns his interests with that of the fund's investors;
- By structuring the fee this way, the upfront cash outlay by a fund manager can be minimised – a factor especially important with newly formed or emerging managers.

Maturation of the market: the rise of internal IR professionals

The private equity industry has become more established over the past ten years, resulting in fundamental changes in the fundraising process. Large, top-quartile fund managers today are likely to have a dedicated investor relations (IR) professional on their staff, sometimes at the partner level, whose role is to develop deeper relationships with current investors as well as with institutions targeted as investors in future funds. Fundraising at these larger, well established fund managers has become a permanent, ongoing process where dissemination of financial reports and hosting annual and other investor meetings has become an extension of pre-marketing for the next fund raise.

The internal investor relations specialist can handle several of the functions of a placement agent. But the trend toward globalisation of private equity capital markets and the ever-changing dynamics at many institutional investors mitigate against a full displacement of a placement agent. Wise fund managers seek to maintain a diversified capital base, seeking investors from a wide range of geographies, institution types and industries not likely to be simultaneously impacted by negative economic forces. Most internal investor relations resources are too small to cover such a broad base of investors – especially potential investors with no current relationship with the fund manager – as effectively as can a global placement agent with a dedicated team of fundraising professionals in constant touch with the market. For this reason, the most successful funds, even those with investor relations capabilities, will still consider using a placement agent for 'top up' mandates, where the bulk of fundraising activity is managed internally, but where the placement agent has a defined role to add value through access to a few targeted new investors.

A few of the very largest fund managers that oversee a portfolio of funds with different private equity strategies actually have full scale internal fund raising teams.

These teams operate in the same manner as external placement agents do, and are continually in the market with one fund or another. These managers have little need for external resources to assist them, but the level of staffing required means that this is a solution only for the largest groups.

Who is the client?

One key issue that affects a placement agent operating as a manager of long-standing and long-term relationships, rather than simply a 'Rolodex for hire,' is: Who is the client?

The fund manager selects and retains the agent to place his fund and is the party contractually responsible for paying the fee. But an agent that enjoys relationships of trust with investors, built over a long period of time, must maintain a balance between the needs of both investors and fund managers. Fair treatment, integrity, honesty, and openness are the foundation for developing any enduring relationship. The ultimate value added of a placement agent is when it offers these attributes of its relationship with an investor as the starting point for a long-term relationship between the fund manager and the investor. Without such a rapport with investors, a placement agent would be hard put to influence an investor's decision to investment in a particular fund. The relationship with both investors and fund managers can be enhanced by the alignment of interests that comes from a policy of consistently and systematically investing a meaningful portion of placement fees in the fund being raised.

Summary

The role of placement agents can vary dramatically depending upon their experience, approach to the market, and the needs of their clients. New emerging managers or firms in transition often need the complete range of services offered by an experienced placement agent. Well-established, successful firms are more likely to use placement agents for targeted help in expanding or solidifying their investor base. In either case, simply hiring a Rolodex late in the fundraising process is not usually a value-added proposition. Those fund managers who hire an agent strategically to build a stronger franchise, through developing and expanding a durable base of quality institutional investors quickly and efficiently, are much more likely to receive value for their money. ■

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