Business Standard

LPs squeeze private equity fund managers to slash fees

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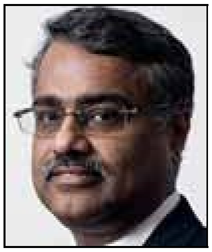

Necessity, they say, is the mother of invention. In the high adrenaline world of private equity (PE), it's also a matter of sustenance. So at a time when raising money for new PE schemes from global high new worth individuals (HNIs), family offices, endowment and educational trusts or pension schemes — or any such limited partners (LPs) in industryspeak — is becoming exceedingly tough, GPs from these fund houses are coming out with innovative ideas to woo global investors.

Forget about lock-ins, assured IRRs or ROEs or any other high finance jargon. In this mad scramble (*see chart: On the road*) of getting a cheque signed from the fat cats, some GPs are even willing to give personal guarantees against investments, offer a liquid pool of cash — in many cases from their own pocket — for "any time" redemptions and are willing to negotiate and split the traditional 2 per cent management fee.

Lawyers, global placement agency chiefs, and the fund managers will not take specific names but recently two real estate PE funds, based out of Mumbai and Delhi, raised about Rs 300 crore each after negotiating with LPs and by keeping a liquid cash pool.

ON THE ROAD

Fund	Fund manager	Size ($mn)	Status
Multiples Alternate Assets	Renuka Ramnath	450	400 (raised)
CX Partners	Ajay Relan	550	515 (closed)
Exponentia	PR Srinivasan	400	In process
Pravi Capital	Jayanta Banerjee	200	In process
MCap Advisors	Subbu Subramaniam		In process
Arka Capital	Rajesh Khanna		Yet to start

So how does this work really? How liquid or feasible is the pool? To start with, most dyed-in-the-wool PE bosses will tell you it's all about your pedigree. If you have a proven track record, there is still money that will chase you without breaking into a sweat.

Easier said than done, comes the rebuff.

According to industry experts, typically the investment cycle in PE is long. So now instead of money getting locked in for 8-9 years for the entire fund life, LPs can get 15-20 per cent of their invested amount back within three-four years. With this liquid pool, GPs can have ready cash to buy out their LPs at any time.

This liquid pool could be around 20 per cent of the total fund size. As per the new agreements, many fund managers are ready to reimburse 15-20 per cent of an LP's capital either with their own money or with that of another LP.

Siddharth Shah, head, funds practice group, Nishith Desai Associates, said, "Some are willing to offer an option of earlier liquidity through a liquid pool created by sponsors to offer a partial buyout of the interests at the end of the specified period ranging from three-four years from the date of contribution or some offer the facility of loan against the units held."

The idea notwithstanding, the jury is still out on the viability of such a scheme.

Ask one of the poster boys of Indian PE, Ajay Relan, the former boss of Citigroup's PE play in India and the current founder of CX partners. He raised above $500 million last year when the markets were still choppy. Relan's response: "Though GPs mooted these plans to the LPs, it will be tough to find out a liquid pool if the fund size is not too small."

According to VCCedge data, 27 funds have raised $13 billion in 2010. That's almost double the amount raised just a year before.

Subbu Subramaniam, founder and managing partner at MCap Fund Advisors Pvt Ltd and a former Barings India Partner, accepts that "some GPs have had to accede to investor requests."

Charles R Daugherty, Managing Partner, Stanwich Advisors LLC, a global placement agency that helps GPs in fund-raising, said, "While institutional investors are increasingly interested in gaining exposure to India, many are not yet fully comfortable that PE can sufficiently outperform the public markets."

Reason enough for fund managers being ready to accept splitting the prevalent two per cent fund management fee. Many GPs are now ready for a staggered pay: one per cent of the assets under management as fee at the time of commitment and the remaining part at the time of actual capital deployment instead of getting the entire two per cent at the time of commitment. Normally, LPs offer two per cent management fee and 20 per cent carried interest.

"In large fund raises, LPs sometimes negotiate a performance-linked management fee as against a flat two per cent on the committed capital. This, however, works only for larger-sized funds where the two per cent management fee is likely to generate a surplus. Mid-sized or smaller funds may find it difficult to meet the overheads otherwise," said Siddharth Shah.

"The idea of paying fees on committed capital as opposed to invested capital is that LPs must never be under any time pressure to invest the money as it is probable this could lead to wrong investments. Hence this idea of paying one per cent fee to begin with and another when actual investing happens is not consistent," Subbu added.

Indian GPs, according to Stanwich Advisors' Daugherty, have, for the most part, been investing for a short period of time. Most have very limited track records and, as a result, lack sufficient evidence to demonstrate they can identify good companies, perform due diligence, finance them, create value, and then sell them to return cash to investors. "Some track records have a few realisations but most investments are still shy of liquidity events," he added.