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FUNDRAISING

Is the train leaving the station for Chinese GPs?

China remains the preferred emerging market for LPs – but are local managers doing enough to get the right investors on board? By Niklas Amundsson

It is a well known fact that investors globally are looking to increase exposure to emerging markets, including Asia in general and China in particular. Across the board, LPs are looking to take their emerging market allocations from 0-5% to 20-30%. In the short term, this increase will most likely come from LPs reducing their exposure to Europe, going from overweight to neutral Europe.

China still remains the preferred destination within emerging markets, but many LPs are struggling to deploy capital with Chinese GPs for a number of reasons. These reasons go beyond the general emerging market concerns around political risk and corporate governance issues, which are common in emerging markets as they mature and become more institutional.

China's superior growth is often cited by LPs as the main attraction of the Chinese market. However, taking a beta strategy in private equity in China by investing in a broad range of GPs to ride the China growth wave could be a very expensive experience, and one better suited for public markets.

Private equity is an alpha game. It is all about picking the correct GP that can demonstrate a true value-add and beat the market. Very few Chinese GPs have been able to repeatedly demonstrate this by returning capital to its investors across economic cycles.

Amundsson: *LPs struggling to invest in China GPs*

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LPs are increasingly taking a scientific approach, comparing private equity performance to the listed markets. This has been the practice for a number of years for a well-known Canadian pension plan, which relies on its private versus public markets benchmarking exercises in making investment decisions. Likewise, one of the large Australian Superannuation Funds benchmarks GPs versus the public market such that the GPs need to outperform the public markets by 500 basis points to warrant an investment.

There are over 2,000 GPs in China, according to a local data provider. However, the GPs that match up to international LPs global standards are limited. When one of them comes to market, it tends to be a very quick and successful fundraising.

WITH GREAT POWER COMES GREAT RESPONSIBILITY

As fund sizes of a few Chinese GPs increase, so will their ambitions. Many Chinese GPs have leveraged their private equity platforms to grow into other

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product areas, such as venture capital and real estate. The latest trend is for top Chinese GPs to look at becoming pan-regional platforms. However, when venturing outside its core country, other Asian GPs have had teething problems where performance has been questioned and LPs have voted with their feet. As a consequence, it is becoming increasingly important for successful GPs to link up with LPs that have clear and consistent ambitions from the outset.

Successful Chinese GPs will need to be careful that a strategy-shift (such as new regions, multiple-currency funds, multiple product etc.), does not become a strategy-drift. Asset gatherers and asset managers are not well received by the LP community in today's market.

At the same time, some Chinese GPs (as well as their Indian counterparts) have suffered succession and team retention issues. Part of this is driven by the entrepreneurial spirit of many private equity professionals, with the best and brightest progressing quickly. However, fresh top talent has to be given the opportunity to grow into management and leadership roles and not kept outside the limelight and the carry structures. The most successful global private equity houses have often given their rising stars the opportunity to take on their next venture internally, heading up the next product or fund being launched.

Some clever Chinese GPs have started to adapt to a similar style. LPs pay particular attention to the control and economic arrangements as well as potential conflicts of interest surrounding these new ventures but if they tick all the right boxes they are well received by LPs, who in many cases already know key individuals from their previous roles in the organization.

THE ART OF POSITIONING

The art of positioning is essential in attracting international LPs. This is particularly important for emerging managers, such as many up-and-coming Chinese GPs. Claimed government connections and proprietary deal flow are no longer enough to even attract LPs to conduct due diligence.

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The issues of value add and performance may seem equally generic in nature. They are often addressed in PowerPoint presentations by McKinsey-inspired flow and bar charts, with statements such as "partner of choice" and claiming top-quartile performance. Historically, such statements might have been sufficient, but in today's market, due diligence tends to go a few layers deeper.

In order to attract investors, a lot more ancillary and customized materials are now required. A recent MVision private equity fundraising in the region required over five thousand pages of materials, as well as new models being designed to address the unrealised portfolio, customised ESG reports, and other investor-specific questionnaires that had to be completed. Even the best resourced investor relations teams would struggle to keep up with the demands and intensity of project managing many current campaigns.

The latest trend in China has been to hire a dedicated investor relations person in an effort to become more institutional and to deal with international LPs. Some GPs have recently started building investor relations teams, resulting in valuable business for recruitment agents that otherwise have had a slow year. There have generally been two schools of thought in the recruitment process: a mid-level person is hired to project manage a fundraise, or a senior person is hired for his/her particular LP relationships.

These recruitment strategies may be successful for smaller or mid-sized GPs, but for those wanting to attract the largest investors globally, the back office is increasingly important.

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The due diligence process, with its customised due diligence questionnaires, is only the start of the LP-GP relationship. Once the Fund is investing, the increased disclosure requirements from LPs mean that there is a constant demand for additional information to be reported, regular ESG training undertaken and questionnaires filled out. A strong back office is essential to respond to these requirements.

THE SPECIAL DEAL

In today's market, only 80 LPs are in a position to make individual fund commitments of $100 million or more, down from 200 or so LPs a few years ago. A select group of 15 investors still has the capacity to write $200 million cheques. In 2007, this group would happily make fund commitments of $500 million.

These global mega-investors are aware of their unique position and will in many cases be looking for a special deal. Singaporean SWFs and Canadian pension funds have been renowned for their early involvement in the industry in China. In the past, 'a special deal' was often linked to reduced economics on the fund commitment. Today, this is predominantly linked to co-investment rights. A number of US public pension funds have been deploying large amounts of capital through separate account structures. However, these have predominantly been with global private equity firms, across several strategies. It is probably only a matter of time before we will see an announcement of a commitment to one of the multi-strategy GPs in China.

In 2011, the Chinese GP was not concerned with the increasing information demands from international LPs and their tedious selection processes – domestic capital was far easier and quicker to attract. RMB-denominated structures attracted twice as much capital as their USD counterparts ($25.9 billion compared with $12.8 billion), according to AVCJ. Even the global private equity firms jumped on the bandwagon to raise RMB capital, although the success of those fundraises have been mixed. There has also been a reverse flow of fundraising interest in the last year, where RMB managers have turned to USD structures in hope of becoming more institutional and secure long-term capital.

RMB LPs need to be managed too, especially since they often have a different time horizon in mind when making the investments. The majority of RMB capital is either raised from local guidance funds, which may have alternative agendas, or through wealth management firms which can charge up to 50 percent of future management fees. The biggest problem though is the default rate of HNW investors, who may have made the commitment on an emotional basis and now want to focus on the next big thing rather than meet capital calls for the next five years.

LAST CALL FOR CAPITAL

Different GPs face very different fundraising challenges. The established GPs need to find LPs that have similar ambitions to themselves, which will allow them to continue to grow as the GPs mature. They also need to find a way to manage due diligence processes and cope with reporting requirements, which will be very resource intensive.

Emerging managers are searching for LP partners that go beyond ticking the box to understand their story. GPs need to have patience and should never underestimate LPs appetite for a 'special deal', such as an early peek at a co-investment opportunity, even if such an arrangement is only to get to know the investment processes and people better.

The hiring of a placement agent once the Fund has launched could address some of the problems a fundraising in China may face. However, getting the right trusted advisor on board early to assist with the marketing strategy and positioning is a better solution. The train has not yet left the station, but the conductor is ready to blow his whistle. China still remains the preferred emerging market, but one day it will all change and LPs will move on. ■

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OVERVIEW

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Since its inception in 2001, MVision's clients have raised over $81 billion of capital, $46 billion of which was raised after 2008, including $8 billion for Emerging Market funds.

HIGHLY TAILORED SERVICE

MVision offers an extensive range of services in preparing, structuring and placing alternative investment funds, and providing in-depth market knowledge, comprehensive marketing material production and global project management.

MVision is committed to ensuring rapid and successful fundraising for its clients with the least possible disruption to their on-going business. It has never been more important that General Partners should remain free throughout the process to concentrate on investment and portfolio management.

MVision aims to help clients successfully navigate the current market to achieve a successful fundraising through an efficient and differentiated fundraising process.

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THE TEAM

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A truly international team, its members represent 16 nationalities and speak 14 languages.

CLIENTS

MVision has established a reputation for delivering the highest levels of strategic advice, private placement skills and professionalism, routinely exceeding the most demanding expectations of its clients worldwide.

MVision's worldwide client base is composed of current and future market leaders in the major and emerging economies globally, with whom we work on a long term basis. The company's goal, based on the belief that fundraising is far more than a one-time event, is to assist its clients with the on-going task of funding and growing their businesses whilst effectively managing the issues associated with expansion – interaction, positioning, growth and success.