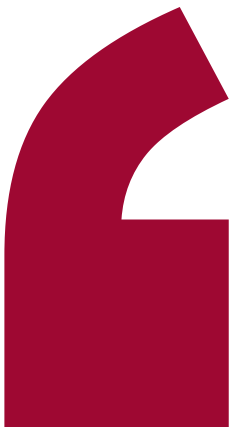
Global Investor *Attitudes*
to Private Equity *in the UK* 2009



British Private Equity and Venture Capital Association (BVCA) / Preqin LP Survey

bvca

The **voice**
of long-term
investment

Contents

Objectives 4

Overview of Findings 5

Methodology 8

Participant Selection 9

Responses to Closed-Ended Questions 10

Responses to Open-Ended Questions 33

Appendix 1
The 2009 BVCA–Preqin Survey into Global Investor Attitudes to Private Equity in the UK 41

Appendix 2
Contributors 46

Objectives

As part of its continuous research into private equity, the BVCA, in conjunction with Preqin, carried out a survey during July 2009 in order to better understand the attitudes of international investors to private equity in the UK.

Overview of Findings

The survey documented the views of 100 major LPs drawn from the UK, Europe, North America and other regions. It included a variety of different types and sizes of institutional investor, designed to give a representative sample of the types of institutions which invest in the funds of BVCA member firms. The bulk of the survey was carried out during July 2009, and included both closed-ended (multiple choice) questions and open-ended questions, designed to give LPs an opportunity to express their views in an unconstrained and qualitative manner.

Several important findings emerged from the survey:

1. **Short Term Challenges:** the challenges faced by the industry in the current difficult financial environment are well understood, as regards fundraising, making investments and achieving exits. 54% of LPs are now at or above their target allocations to private equity, which has constrained many of them from making commitments to new funds. However, a significant proportion of the LPs surveyed are still looking for new investment opportunities. The median target allocation to private equity among the LPs surveyed was 10%, and 82% of them intend to maintain their current targets over the short term (12 months). Among those who intend to change their targets, there are more LPs who intend to decrease them (11%) than increase them (7%). The reasons cited by those LPs intending to reduce their target allocations are primarily related to liquidity concerns and / or the 'denominator effect'. Taken together, these factors highlight the fundraising challenges facing the industry over the short term.

2. **Medium Term Prospects:** in contrast to the challenges over the short term, the prospects over the medium term (24 months) are significantly more favourable. 15% of the LPs polled intend to increase their target allocations over the next 24 months, compared to only 5% who intend to decrease them over this period. The reasons that LPs give relate primarily to the potential for superior returns from the asset class, and the benefits of diversification in their portfolios. Given the hopefully more enduring nature of these factors as compared to the liquidity and 'denominator' reasons for reducing allocations cited in 1 above, there are good grounds for optimism that the long term trend towards increased allocations for private equity among LPs will continue.

3. **LP Optimism on Returns:** several questions focused on LPs' expectations for future returns, and they expressed cautious optimism, consistent with their intentions to increase target allocations noted above. LPs expect net returns over the coming five years to be only slightly lower than those experienced over the past five years (approximately 45 BPs lower), although it should be noted that there is a wide spread of expectations here, with a small minority of LPs (5%) expecting returns to decline by 500 BPs or more. It has often been observed that private equity fund vintages that have their investment periods during recessions tend to deliver good returns, so it is encouraging to see that most LPs acknowledge this, and feel that the 2008 – 2010 fund vintages will generate strong returns (87% of LPs agreed with this). Taken together, this general optimism on prospective future returns provides strong support for the industry's medium- to long-term fundraising prospects.

4. **Changing LP Base:** all LPs have been affected by the turmoil in financial markets, but some have been hit much harder than others. This applies not only to individual institutions, but also to different types of investor. The survey asked LPs whether they were currently below / at / above their target allocations for private equity, and also whether they are currently looking for new investment opportunities. Unsurprisingly, there is a clear correlation between the two: most LPs who are currently at their target allocations are still looking for investment opportunities, but very few of those who are above their targets will do so. High proportions of endowment plans, foundations, family offices and corporate pension plans said they are now above their target allocations, and correspondingly many of them said they are not currently looking for new investments. Banks are

also largely excluded from new investments at the present time. Significantly fewer asset managers, public pension funds and insurance companies are currently above their target allocations, and many of them are still under their targets. As a result, many more of them are still looking for investment opportunities. Funds of funds are also largely still looking to invest. The conclusion from this analysis is that the mix of LPs who will be committing to new funds over the short term will be different to that of the recent past: public pension plans, insurance companies, asset managers and funds of funds will become even more important sources of capital for the private equity industry.

5. **Geography of Secondary Importance:** the survey explored LPs' attitudes to funds managed by GPs in different regions, and it is quite clear that this is of secondary importance to them. Just over half of LPs (52%) have specific target allocations by region, but even among those that do, they emphasize the importance of looking at the strategies and strengths of individual firms as a higher priority than considering geographic location. Many LPs (48%) do not have geographic targets at all, taking a more opportunistic approach to selecting managers. To the extent that LPs have geographic targets, they overwhelmingly consider the UK within their European allocation, and not as a separate region.

6. **UK Industry Well-Positioned:** subject to the caveats in 5 above, it is clear that LPs hold UK firms and the UK private equity industry in high regard. The UK is seen to be the second most significant and established private equity market in the world after the US, and is generally perceived to have firms with greater experience and longer track records than elsewhere in Europe. Some LPs saw UK firms as combining good features from both the US and Europe. There was some slightly concerning evidence that LPs felt the historic performance of UK funds was on a par with the rest of Europe, but behind the US and emerging markets. However, when asked about prospective future returns LPs clearly believe that UK firms will perform in line with the industry generally. When asked about their strategies regarding funds of different types, it is clear that international LPs consider UK firms to have particular strengths in buyout (especially mid-market) and secondary funds. Their opinions of the UK's strengths in venture, distressed, turnaround and real estate funds are less favourable, so this may be an area for firms and the BVCA to focus on in their communications.

7. **Prospects for Growth:** LPs were asked whether they currently invest with UK firms and / or whether they intend to do so in the future. It was clear from the responses that a higher proportion of European LPs already invest with UK firms than do North American LPs. Conversely, significantly higher proportions of North American LPs consider themselves likely to start investing with UK firms in future. This suggests that the UK private equity industry's greatest prospect for growth in investment flows comes from North America, as opposed to Europe. (The sample size did not permit a similar analysis for other regions.)

8. **Communications and Transparency:** from the GP's perspective, it is clear that the private equity industry has improved its communications with LPs in recent years, and has become significantly more transparent. However, it was equally clear from the responses to the survey that LPs feel a pressing need for more communication and transparency. The current turmoil in financial markets clearly has a role to play here, and several LPs mentioned the need to be kept informed on a regular basis by their GPs, even (or perhaps especially) when things were not going well. Most LPs manage their private equity portfolios with very small teams: even though our sample included many large institutions, 32% of the LPs surveyed had one or fewer full time staff focused on private equity. This factor makes it even more important for GPs to communicate clearly and proactively with their LPs. Equally, at a time when governance and risk factors loom large for investors, those private equity firms that satisfy their LPs' requirements in this regard stand to gain a competitive advantage.

9. **Alignment of Interests:** as in point 8 above, private equity has a good record of aligning interests between GP and LP, but the investors polled also raised this as an important area of concern. LPs would like to see their GPs committing more to each fund, and want to see fee and carry structures that focus the wealth creation opportunity for the GP squarely on the carry. Preqin's other analysis of fees and terms suggests that this has always been and remains the case for all but the largest funds, with the exception of deal-related fees, which does raise important issues of alignment. The fact that many LPs have raised this issue confirms that it should be an area of focus for clearer communications from the GP.

10. **EC Directive:** many non-European LPs are not familiar with the Directive, and so cannot comment. Among the LPs that are familiar with it, there appears to be a clear consensus that, although well-intentioned, the Directive has been drafted more from the perspective of hedge funds rather than private equity funds, and that it may cause more harm than good. Most LPs felt that there was no need for a Directive in the private equity market, and that implementation could prove to be costly and restrictive for firms.

11. **BVCA Opportunities:** the BVCA is held in high regard by the LPs surveyed, and some mentioned that it is among the best such bodies in the industry. In terms of what areas LPs felt that the BVCA could be focusing on, most of these revolved around the communications and transparency issues above (areas which it is, of course, already active in). LPs felt that the BVCA should be encouraging member firms to be as transparent as possible, adhering to industry-wide standards. In addition, LPs felt that the BVCA could help to achieve consistency in standards of performance reporting and could play a role in the collection and dissemination of this information.

Methodology

The survey polled 100 institutional LPs to solicit their views on private equity, with specific reference to how these investors view UK-based private equity firms, in comparison with those based in the US, Europe and elsewhere.

The BVCA and Preqin worked together to define a series of closed-ended and open-ended questions aimed at addressing the issues of interest to the private equity and venture capital industry in the UK. The closed-ended questions gave participants a range of pre-defined answers to select from. These were designed to generate information in a format conducive to statistical analysis. The open-ended questions were designed to give investors an opportunity to give their views in a more qualitative sense, and without any of the constraints inherent in a closed-ended survey. The questionnaire used is listed in Appendix 1.

Preqin conducted a pilot study of 18 LPs during June 2009, the objective of which was to refine the final survey questions for the full study, which was completed during July 2009.

The survey was carried out by emailing 1227 LPs, who have investment experience in PE funds managed by firms based in the UK, irrespective of the size of their investment. 673 of the total 1227 LPs were European, 446 North American and 108 Rest of World, which reflects the target geographic mix of investors (more details are provided in the following section). The LPs are asked to assist in the study through an online data collector, which enabled them to fill out their responses to the closed-ended questions online. Preqin then contacted all respondents by telephone to discuss the open-ended questions. In total, Preqin received responses to the survey from 100 LPs.

LPs were informed that the survey was being conducted by Preqin on behalf of the BVCA, and were told that their responses would be kept confidential. We wish to express our appreciation to all the respondents for their participation in the study, and will be sending them a copy of the findings from the research. Responses are treated anonymously, so individual participants are not named in this report.

Participant Selection

Preqin aimed to speak to a representative mix of LPs, with a target balance of 50-60 European (including UK), 30-40 North American and 10 Rest of World. This target mix of LPs is broadly in line with the geographic mix of investors in the funds managed by BVCA member firms. In particular, this meant that the mix of LPs surveyed was weighted somewhat towards European investors, as opposed to investors from North America and the rest of the world. The objective was also to include a broad mix of different types and sizes of institutional investor within the 100 LPs surveyed.

The sample of institutional investors Preqin emailed to take part in this study was chosen to reflect this breakdown, i.e. approximately 50-60% of the LPs contacted were European, 30-40% North American, and 10% Rest of World.

Fig's 1, 2 and 3 indicate the demographics of the LPs that responded to the survey.

Figure 1: **Survey Respondents by Type of Institution**

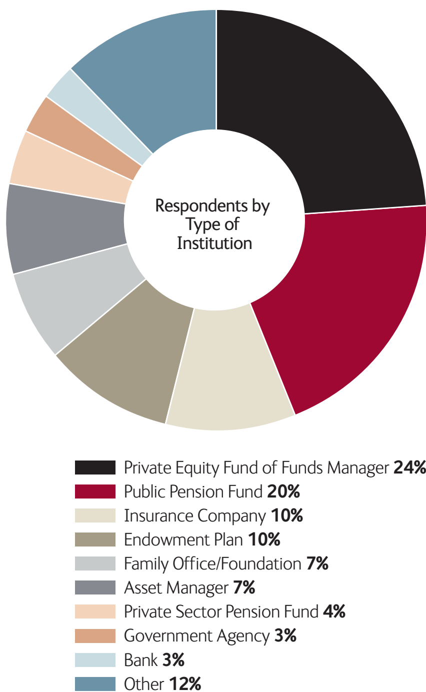


Figure 2: **Respondents by Country**

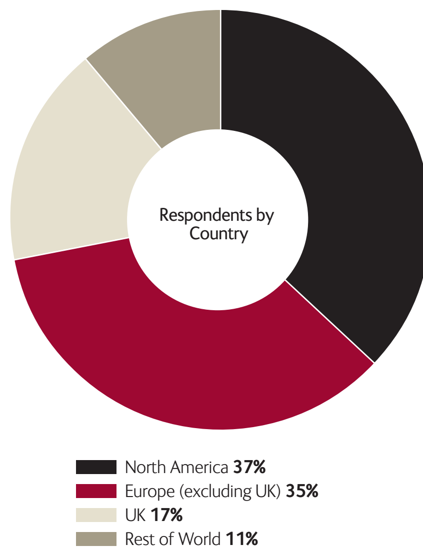
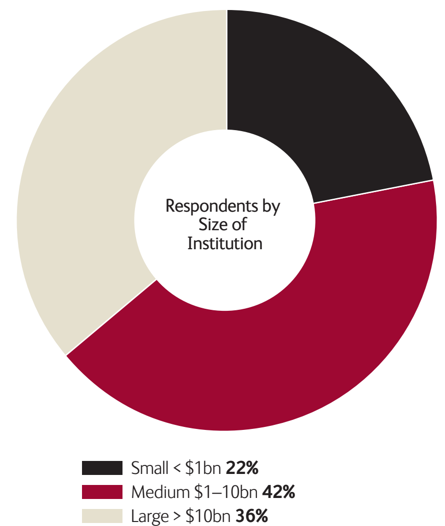


Figure 3: **Respondents by Size of Institution (Assets Under Management)**



Responses to Closed-Ended Questions

Q1: "What are your total Assets under Management?"

As indicated previously in the 'Participant Selection' section above, LPs of a wide range of sizes were included in the survey. Further details are shown in Fig. 4 below, demonstrating the wide spread from institutions with less than £100 million to those with above £25 billion of assets under management.

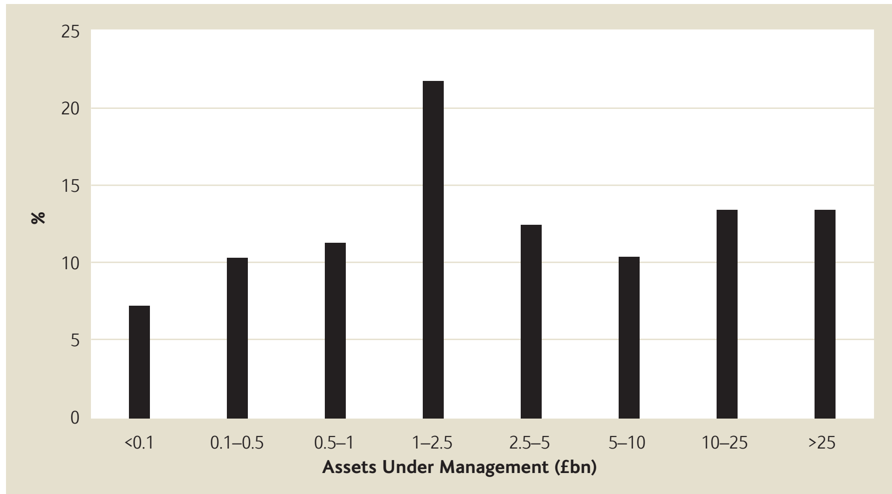


Figure 4: **AUM of LPs Surveyed**

Q2: "How long has your fund / office been investing in PE / VC?"

As might be expected, there was a considerable range here, from the relative newcomers to the asset class to those with many years of experience. A significant majority of respondents (71%) had ten or more years experience or investing in private equity, while 20% of respondents had between five and nine years of experience, and 9% had less than five years of experience in the asset class (see Fig. 5).

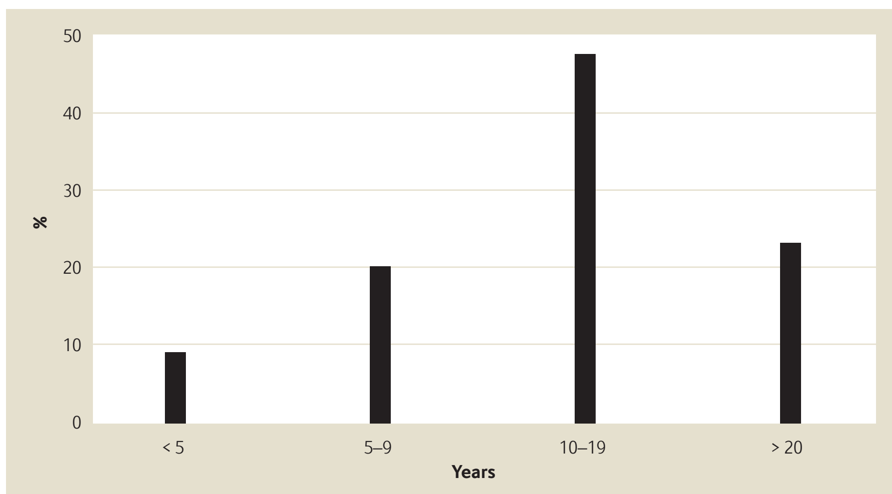


Figure 5: **Years Invested in PE of LPs Surveyed**

The average length of experience among the LPs sampled was 13 years, and showed relatively little difference across different regions. Interestingly, the North American LPs surveyed had marginally shorter experience in private equity than those from the UK, Europe, or the rest of the world (see Fig. 6).

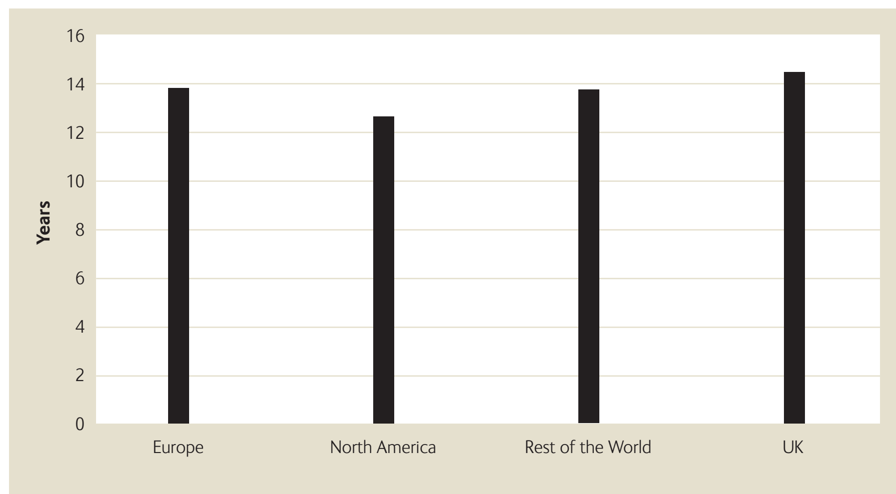


Figure 6: **Average Years Invested in PE**

Q3: "How many full-time investment professionals are managing your fund or making investments for your office?"

Given the wide range in size of the institutions surveyed, one might expect a correspondingly wide range in the size of their investment teams, and this was indeed the case, as shown in Fig. 7. The median number of investment professionals was 8, while the average number was 18.6, influenced by the small number of very large institutions in the sample.

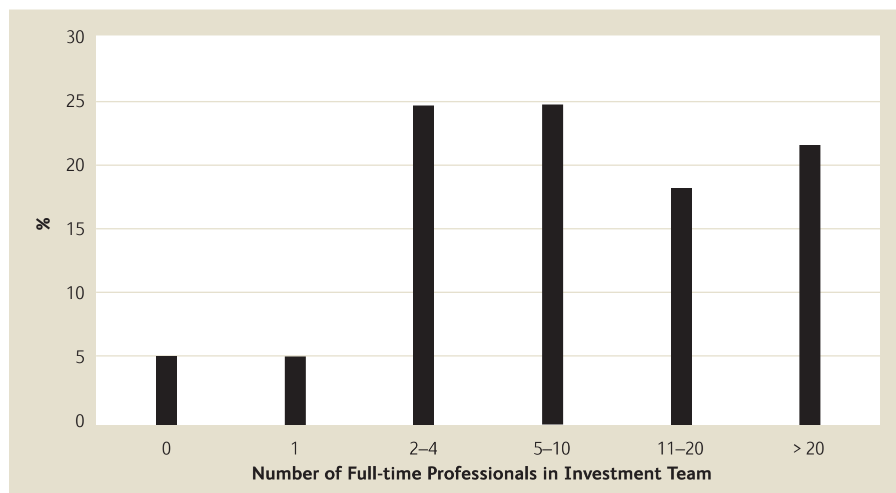


Figure 7: **Size of Overall Investment Team**

Q4: "How many full-time investment professionals are managing your private equity portfolio?"

Where Q3 looked at the size of each institution's total investment team (across all asset classes), Q4 looked at the size of the team involved directly in investing the institution's private equity portfolio.

As would be expected, the size of the team directly involved in private equity investments was much smaller, with a median of only two full-time professionals and an average of 4.9 professionals. Once again, there was a wide range in the size of the team, with 32% of LPs surveyed having one or fewer full-time professionals managing the PE portfolio, and only 8% of LPs having more than ten professionals focused on private equity (please see Fig. 8).

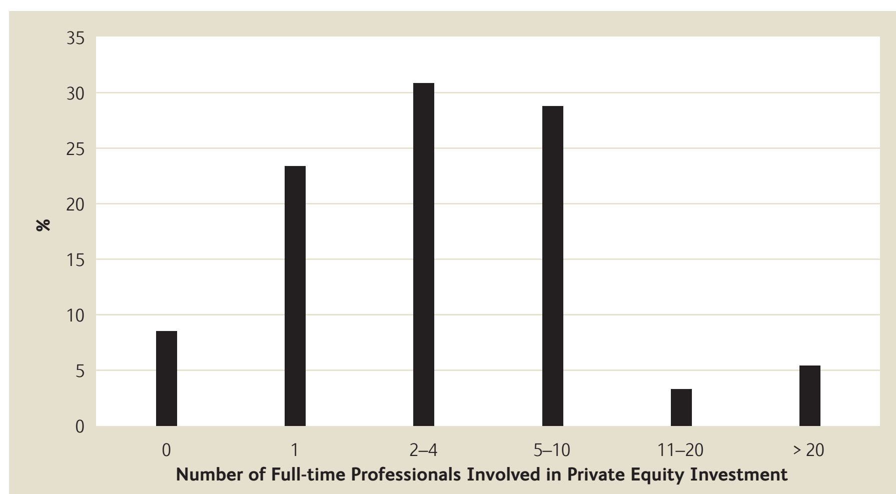


Figure 8: **Size of Private Equity Investment Team**

The LPs surveyed included a number of private equity funds of funds managers, who naturally tend to have larger teams focused on private equity than other types of LPs, and so it is instructive to look at the statistics on team sizes for these two different groups of LPs.

As expected, while the fund of funds firms have large teams dedicated to private equity investing, most institutions have to make do with more limited professional resources focused on private equity. The average and median number of investment professionals for these different categories of investor are as follows:

- Fund of funds firms: average of 10.9 and median of 8 staff; and
- All other LPs: average of 3.0 and median of 2 staff.

Fig. 9 illustrates the difference, and shows that 42% of (non-fund of funds) LPs have to make do with one or fewer full-time investment professionals focused on their private equity portfolios.

Many LPs express their desire for good communications and transparency from their GPs, as commented on elsewhere in this report (please see following section on responses to open-ended questions). This has clearly become more important than ever in the current difficult economic environment. We believe that the relatively small private equity investment teams at most LPs put the requirement for good communications into stark focus. It is very difficult for an LP with a team of only one or two professionals focused on private equity to keep track of their portfolio of fund interests unless their GPs are doing an excellent job of communicating with them. Those GPs who respond to this need and communicate proactively and effectively with their LPs stand to gain a valuable competitive advantage.

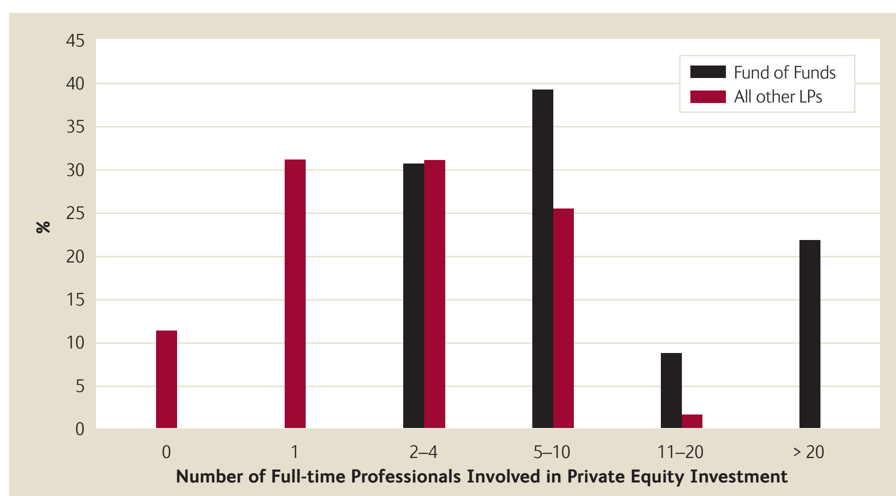


Figure 9: **Size of Private Equity Investment Team - Fund of Funds vs. Other LPs**

Q5: "What is your target allocation to private equity?"

This question looks at the proportion of each investor's total assets under management that is intended to be allocated to private equity, expressed as a percentage of AUM. In this analysis we have excluded the 23 funds of funds in the sample of LPs, as the answer for them is clearly "100%", and our objective was to determine the typical allocations for other types of LP. The median allocation for the LPs in the sample was 10%, and the average was 13.4%.

There is a wide range in target allocations to private equity, with 43% of institutions targeting 6% or less to the asset class (bearing in mind that this only includes those institutions that actively invest in the asset class in the first place), while 32% of institutions target more than 10% of their total assets to private equity (please see Fig. 10).

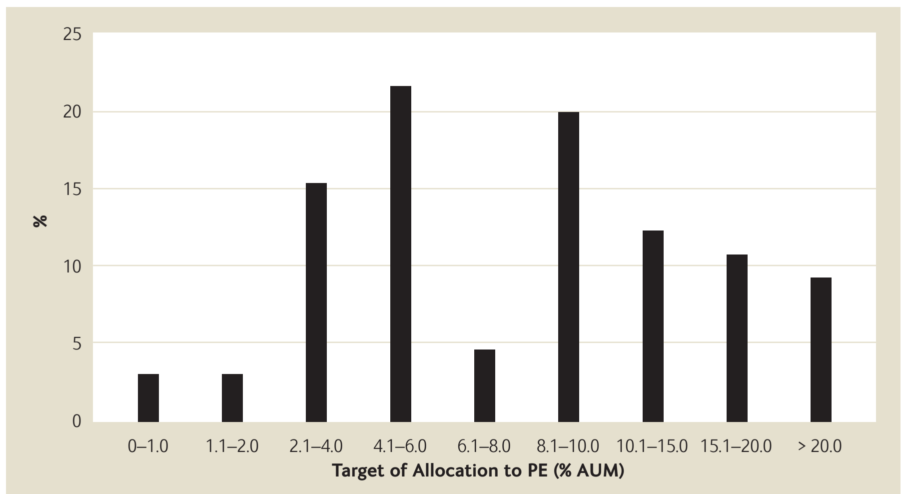


Figure 10: **Target allocation to PE**

To a certain extent, this range in allocations reflects idiosyncratic difference between different individual institutions, but there are also significant differences that exist between different types of institution. Endowments and family offices / foundations have historically been among the heaviest investors in private equity, with median allocations of 14% to 15% of AUM (please see Fig. 11), while most other types of LP have allocations in the range of 4% to 6% of AUM.

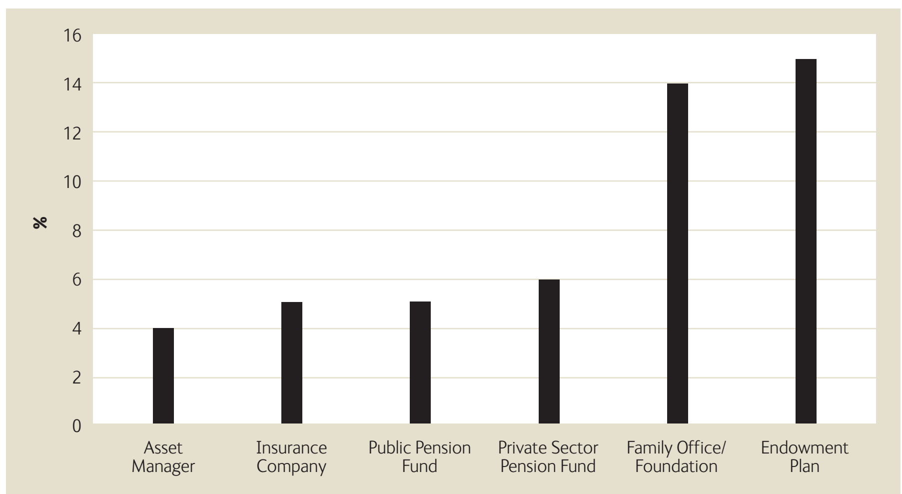


Figure 11: **Median target allocation to PE by type of LP**

Q6a/6b: "Are you looking to change your target allocation to private equity in the next 12 or 24 months?"

The vast majority of institutions plan to maintain their target allocations to private equity over both a one and two year time horizon (82% and 75% respectively). Over a one-year time horizon, slightly more LPs plan to decrease their target allocation than plan to increase it (11% vs. 7% of LPs), but over a two-year time horizon the opposite holds, with 15% of LPs planning to increase their allocations to private equity, and only 5% planning to reduce target allocations over this period (please see Figs. 12 and 13).

These findings corroborate those from other Preqin surveys, which indicate that LPs retain their medium- to long-term enthusiasm for private equity, even in cases where their short-term room for manoeuvre is constrained by liquidity or other considerations.

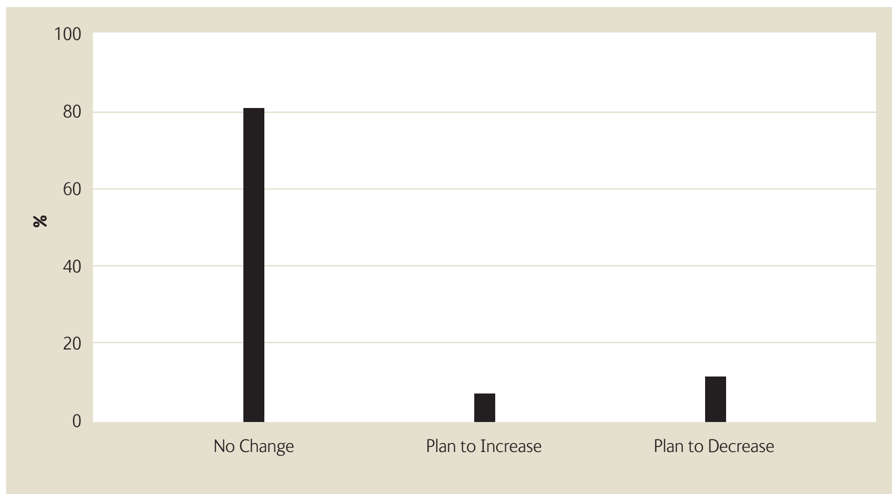


Figure 12: Planned changes in PE allocation - 12 months

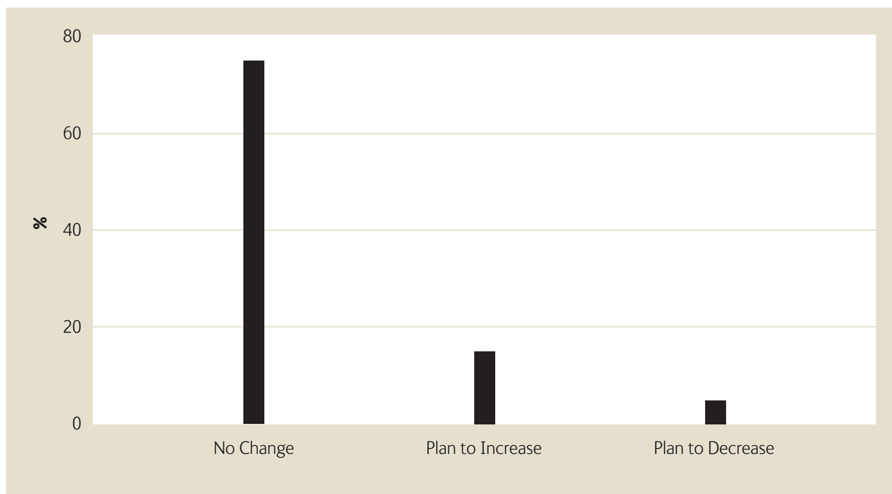


Figure 13: Planned changes in PE allocation - 24 months

Q7: "If your answer for Q6 is yes, could you explain why?"

This question focused on those LPs which were planning to either increase or decrease their target allocations to private equity over the 12 or 24 month period, and aimed to understand the reasons underlying their decision.

The findings are shown in Figs. 14 and 15, and will provide some significant measure of medium- to long-term comfort to private equity firms, in that the reasons driving the decisions of those LPs planning to reduce their allocations are primarily related to short-term liquidity considerations, whereas the reasons driving the decisions of those LPs planning to increase their allocations are primarily related to the potential for superior returns over the medium to long term. While the short-term liquidity-related factors will hopefully diminish in importance as the economy recovers from its current difficulties, the factors influencing those LPs planning to increase their allocations will probably be more enduring. The overall implication from this analysis is that there are good reasons to believe that the established trend towards increased average allocations to private equity among LPs shows little sign of stopping or reversing over the medium to long term.

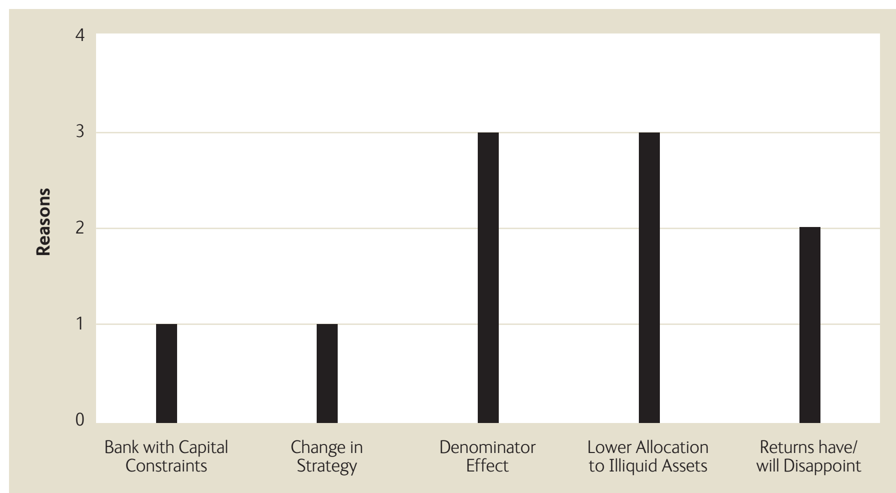


Figure 14: Reasons cited for LPs reducing PE allocations over next 12 - 24 months

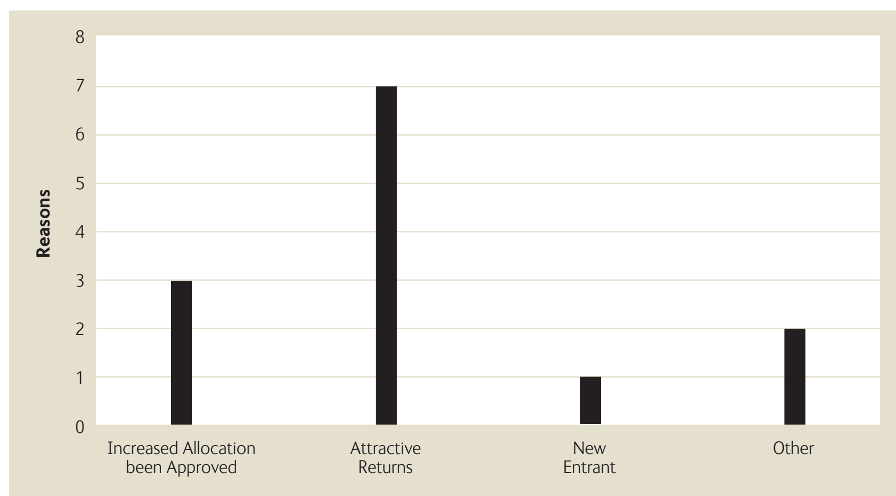


Figure 15: Reasons cited for LPs increasing PE allocations over next 12 - 24 months

Q8: "Are you currently seeking new investment opportunities in Private Equity?"

While the responses to the previous question provide some comfort regarding LPs' target allocations to private equity over the medium to long term, it is inescapable that fundraising conditions are currently very challenging. This question seeks to identify which LPs are currently seeking new investment opportunities, and to derive any patterns therein.

The first, and most significant, point to note is that a majority of the institutions polled (62%) are currently looking for new opportunities in private equity funds, despite the challenging conditions in the financial markets. This proportion is relatively constant across geographic markets (please see Fig. 16), but there are major differences across institutions of different types (please see Fig. 17). Private equity funds of funds are perennial investors (as would be expected), but they are joined by asset managers, public pension plans, private sector pension plans and insurance companies as categories of institutional LP where more than half of the institutions polled are currently actively looking for investment opportunities. Meanwhile, banks, endowment plans and family offices / foundations are currently largely excluded from seeking new investment opportunities, at least as far as the short term is concerned.

Public pension plans are worthy of note here. These institutions have always been among the most important investors in private equity, historically accounting for approximately 25% of total investment in the asset class. They are likely to become even more important sources of capital for the industry over the short to medium term, given the significant proportion of these LPs that are still actively looking for investment opportunities.

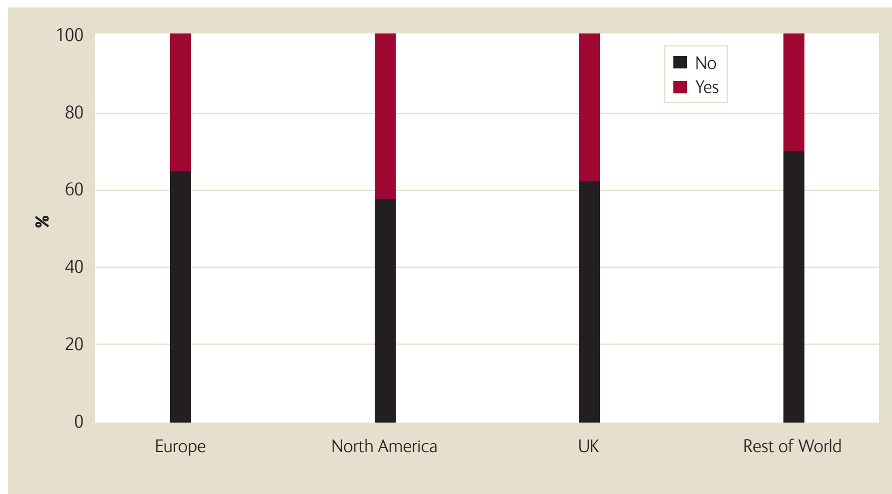


Figure 16: LPs currently seeking new investment opportunities in Private Equity - by region

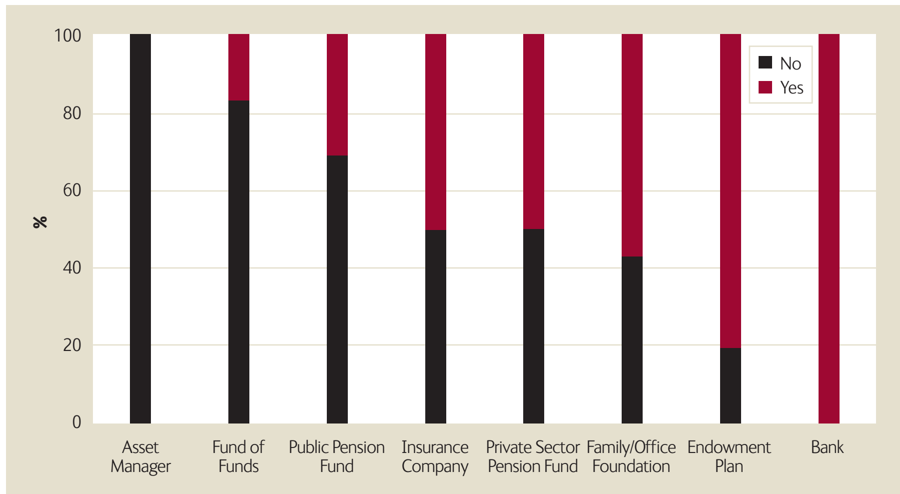


Figure 17: LPs currently seeking new investment opportunities in Private Equity - by type

Q9: "Is your PE portfolio currently below / at / above your target allocation?"

There has been much comment recently about the 'denominator effect', leading to LPs being above their target allocations to private equity as a result of the decline in the value of other parts of their investment portfolios. This is a major issue for many institutions, especially endowments, foundations and banks.

The purpose of question 9 is to assess how many institutions are currently at or above their target allocations to private equity, and the results are shown in Fig. 18. Most of the LPs polled are currently either at (38%) or below (37%) their target allocations to private equity, and only 16% stated that they were above their targets (with a further 8% saying that they do not have a specific defined percentage allocation).

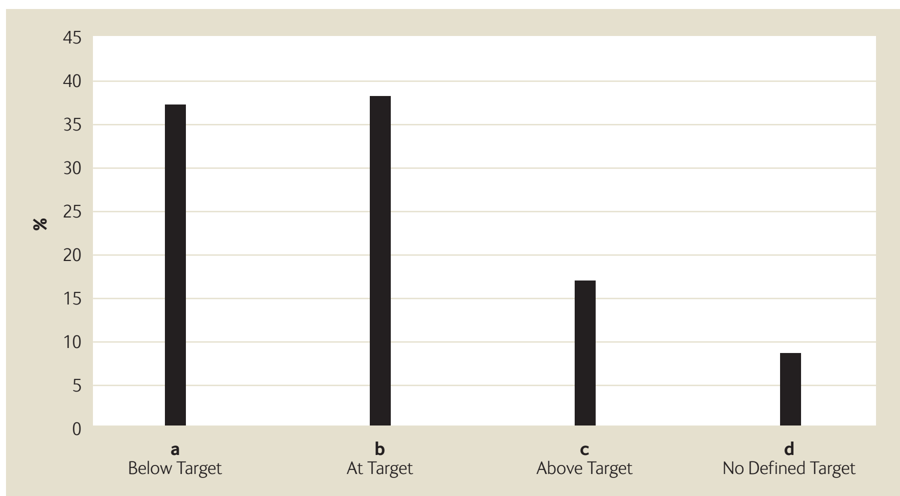


Figure 18: LPs' current PE investments vs. target allocations

It is instructive to combine the findings from this question with those from the previous question, which asked whether LPs were currently looking for new private equity investment opportunities. The results are shown in Fig. 19, which demonstrates a clear pattern:

- Among those LPs that are currently either at or below their target allocations, approximately 70% are currently looking for new investment opportunities; and
- Among those LPs which are currently above their target allocations for the asset class, only 20% are currently looking for new investment opportunities.

These findings confirm the qualitative feedback from LPs, in that they recognise the long term nature of the asset class, and will continue to invest to maintain their allocation even if they have reached their targets. However, once LPs exceed their target allocations they are much less likely to make new investments.

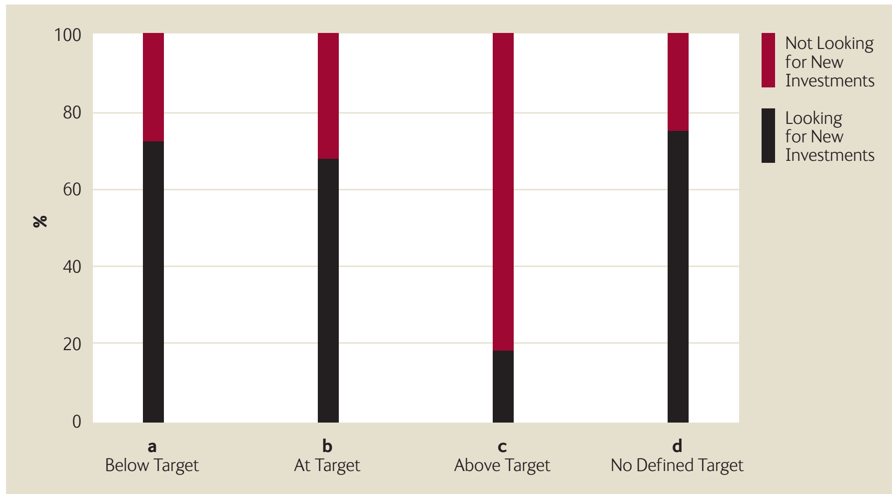


Figure 19: LPs' current interest in new investment opportunities vs. their position relative to target allocation

It is instructive to analyse the responses to this question against the type of LP, and the results of this are shown in Fig. 20. Relatively high proportions of asset managers, insurance companies and public pension funds are at or below their target allocations. Conversely, relatively high proportions of endowment plans, family offices and foundations are above their target allocations. This correlates closely to the proportions of each type of LP that are currently looking for new investment opportunities, as reported in the previous question. (The position of banks relative to their target allocations is somewhat academic, as most of them are not in a position to consider new investments currently, irrespective of any notional target allocation. The position of private sector – i.e. corporate – pension plans, appears strange here, as a high proportion appears to be at or above target allocation. This may be a sample size issue, as the results are based on only four corporate pension plans, a much smaller sample than for other types of LP).

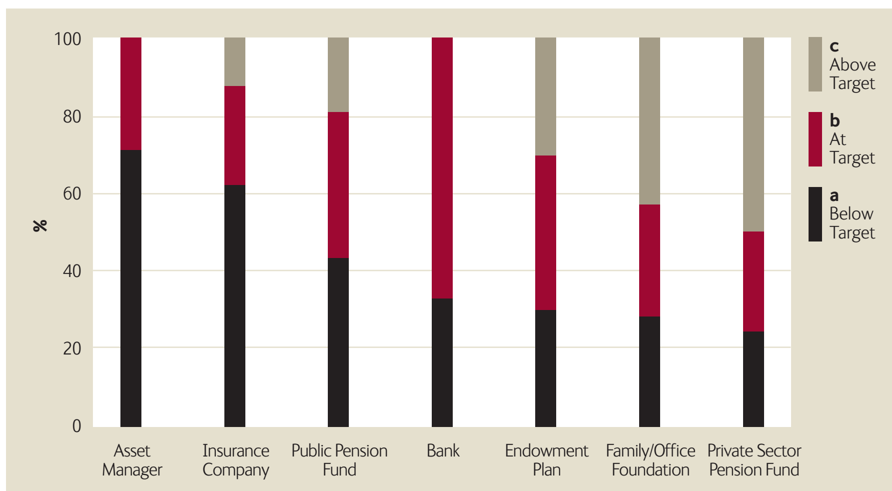


Figure 20: Current PE investments vs. target allocations - by type of LP

Q10a: "Do you have target allocations for the following regions: Europe (incl. UK), UK, US, Emerging Markets?"

Taken together, questions 10a and 10b explore the issue of geographic target allocations, and the answers can be used to derive three specific features of LPs' geographic strategies:

1. **Existence of geographic targets:** does the LP have geographic target allocations at all, or does it focus simply on the attractiveness of each individual fund, without particular regard for geographic allocations?
2. **Granularity of geographic targets:** to the extent that an LP has geographic targets, how granular are the targets? E.g. does it have a target for 'UK', or does it only have a target for 'Europe', including the UK within this broader target?
3. **Quantum of geographic targets:** to the extent that the LP has a target allocation for a particular region, what is the target in terms of percentage of AUM?

Question 10a aimed at addressing the first of these issues, viz. whether the LP has geographic target allocations at all.

The results were evenly balanced, with marginally over half of LPs (52%) having a specific geographic target allocation, and just under half of them (48%) adopting a more opportunistic approach. These proportions varied significantly across regions, with LPs based in the UK and North America being less likely to have specific regional targets (33% and 47% of LPs respectively), and LPs based in Europe and the rest of the world being more likely to have specific regional targets (62% and 60% respectively). (Please see Fig. 21.)

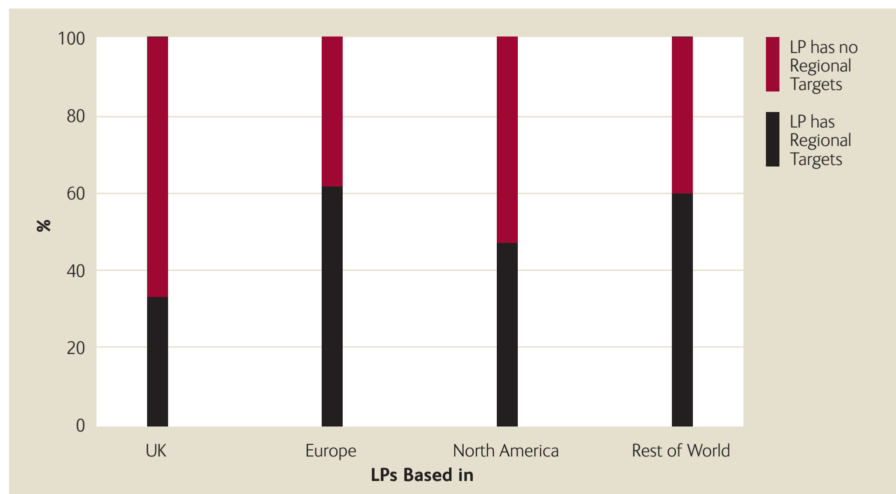


Figure 21: LPs with and without specific regional target allocations

Q10b: "If yes, please detail the percentage of allocation for each category?"

Question 10b explores the remaining two issues, viz. the granularity and quantum of LPs' geographic target allocations.

Fig. 22 takes only those LPs that think in terms of geographic targets to begin with, and shows the percentage of these that have a target allocation for each of the individual regions:

- **Europe and US:** dominate, with 92% and 84% respectively of LPs with geographic targets having a target for each of these regions;
- **Emerging markets:** also score highly (64%), confirming that most LPs think of emerging markets as an identifiable region that they will choose to either invest in or not;
- **UK:** scores much lower, at 26%. Given that the UK is the clear leader in the European private equity industry, and that most LPs that have a private equity investment in Europe will include in this an investment with UK-based firms, the conclusion from this analysis is that most LPs do not think of the UK as a separate region, but include the UK within Europe in their thinking and targets.

This should not necessarily be regarded as an unfavourable outcome: it simply implies that the majority of LPs are either opportunistic in their geographic approach or, to the extent that they think in terms of geographic targets, they include the UK within Europe, rather than having a specific target allocation for the UK. This means that UK firms are competing for allocations within this broader global and European pool of investment funds, and can gain a share of this based upon their own merits.

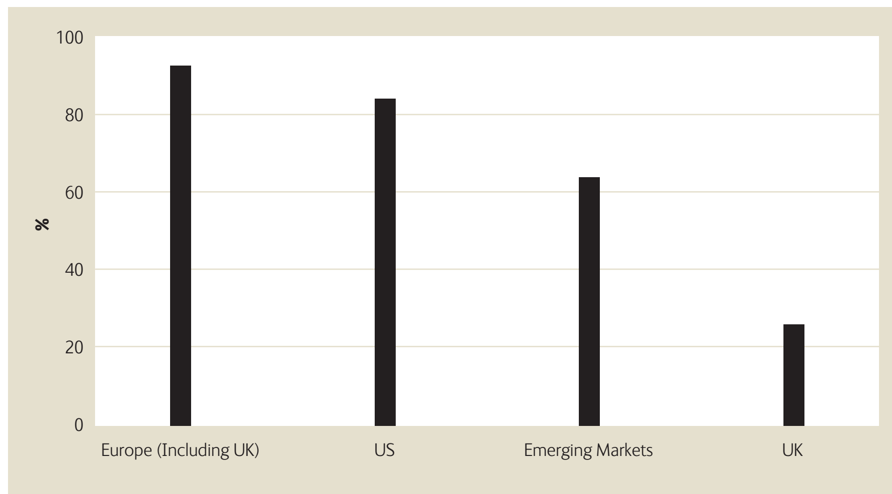


Figure 22: Percentage of LPs with target allocation for each region

Fig. 23 explores the third issue, viz. the average percentage target allocations to each geographic region among the LPs that have one. The average target allocation for the UK among those LPs that have one is 13%. The average target allocation for Europe (including the UK) for LPs that have a specific target allocation is 44%; the average for the US is 48%; and the average for emerging markets is 20%.

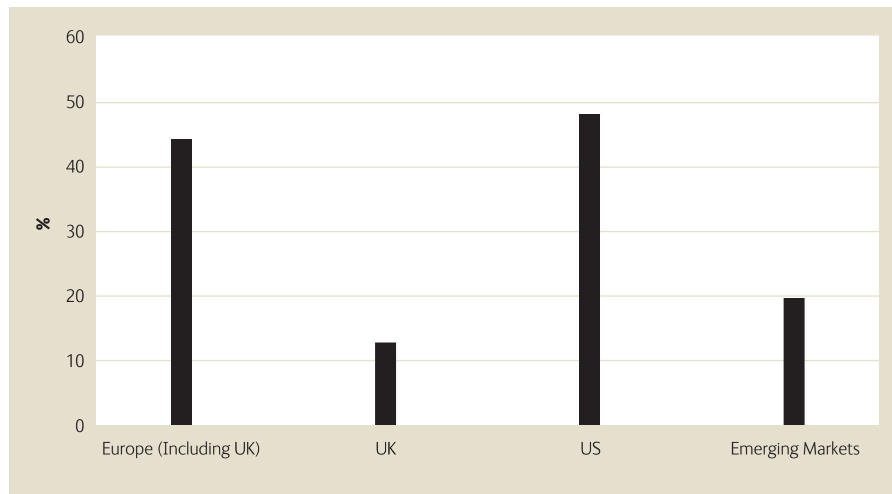


Figure 23: **Average regional target allocations among LPs that have one**

Q11: "How important are the following factors in influencing your decision on private equity allocation?"

LPs were asked to rate the importance of various factors in determining their target allocations, selecting from the five pre-selected reasons shown in Fig. 24 below, and in addition they could specify other reasons of their own choosing. LPs rated the perceived importance of each factor on a scale of 1 to 5.

As Fig. 24 shows, very few LPs felt the need to select any additional factors, so the five pre-selected reasons appear to capture most of the LPs' reasoning in this regard:

1. Return Potential
2. The experience of the LP's own investment team
3. The potential for portfolio risk diversification
4. The requirement for liquidity
5. Recommendations from their consultants

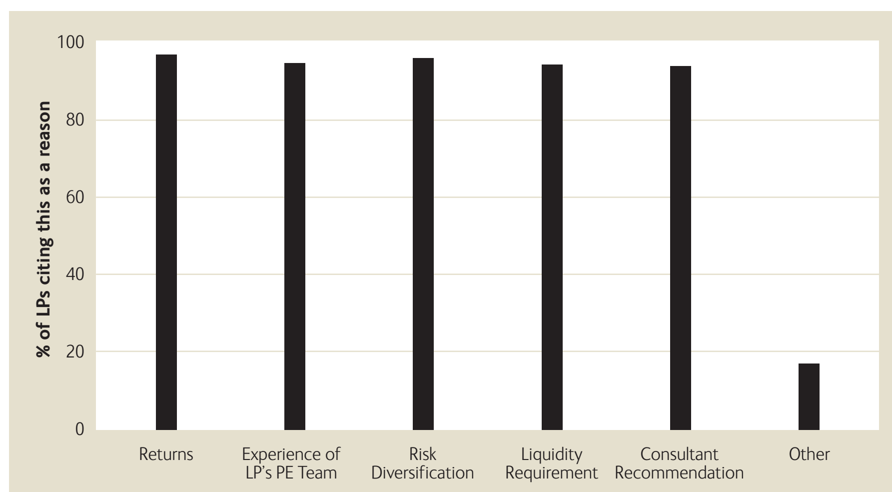


Figure 24: **LPs' Reasons Underlying Target Allocations**

Fig. 25 shows how the LPs rated the importance of each of the factors. The factor considered to be most important is clearly the potential returns from private equity, with an average score of 4.8, and this was selected as being 'very important' by 80% of LPs. The experience of the LP's own team was also rated as being very important, showing that LPs recognise the specialist nature of private equity investment and the need to have a team with the right experience and skills. The ability of private equity investments to provide diversification to the LP's overall portfolio was also rated as being somewhat important, with an average score of 3.6. The final two factors on the list, liquidity requirements and the recommendations of consultants, were considered by the LPs to be significantly less important, with average scores of 2.8 and 2.3 respectively.

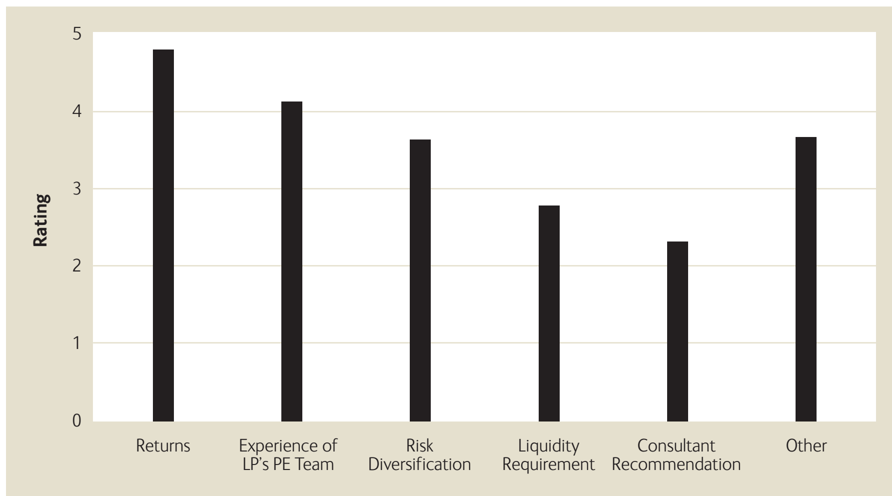


Figure 25: LPs' rating of importance of factors determining PE allocations

Q12: "What resource do you use in determining your PE allocation?"

This question aimed to determine how LPs arrive at their target allocations to PE, in terms of whether they use external consultants, or rely upon their own internal resources. As Fig. 26 shows, the majority of LPs claim to rely more upon their own in-house expertise (58%), or to use a balance of internal and external resources (33%), with very few relying exclusively upon external consultants (9%).

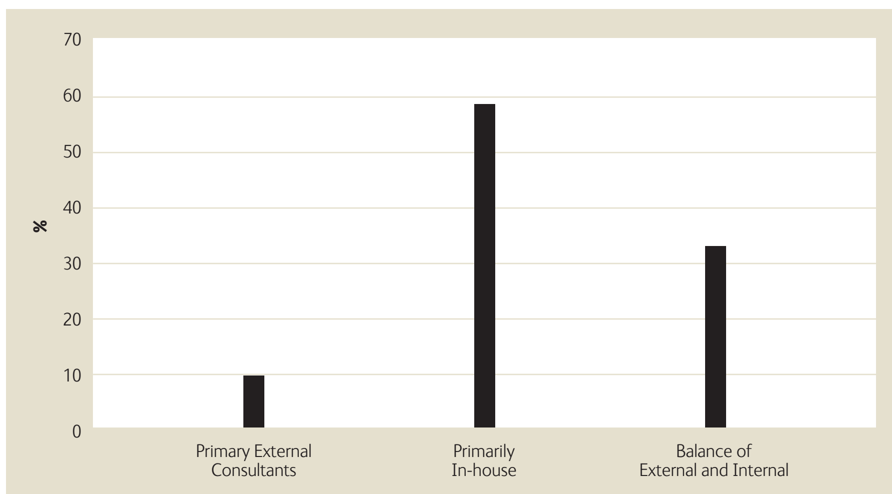


Figure 26: resources used in determining PE allocations

Interestingly, this pattern appears to be remarkably consistent across different regions, and across LPs of different sizes. There are, however, some distinct differences among LPs of different types. Funds of funds rely almost exclusively on their own in-house expertise (95%), while public pension plans rely more heavily upon external consultants (26%) or a balance of internal and external resources (58%).

Q13: "Do you invest in direct funds and / or funds of funds?"

This question was aimed at determining whether the LPs invest only in direct funds, in funds of funds, or in funds of both types. The majority of LPs surveyed invest either in primary funds only (59%), or in both primary funds and in funds of funds (35%), with only a very small proportion of the LPs surveyed (6%) investing solely in funds of funds.

Fig. 27 shows how the responses to this question vary with the size of the LP's assets under management. As might be expected, the LPs which focus exclusively on funds of funds are concentrated toward the lower end of the size spectrum, among those with below £5 billion in AUM, although even here it is a distinct minority (10%) of LPs that invests exclusively with funds of funds. Interestingly, even the largest LPs are users of funds of funds, with 43% of LPs in the largest size range claiming to invest in both direct funds and funds of funds.

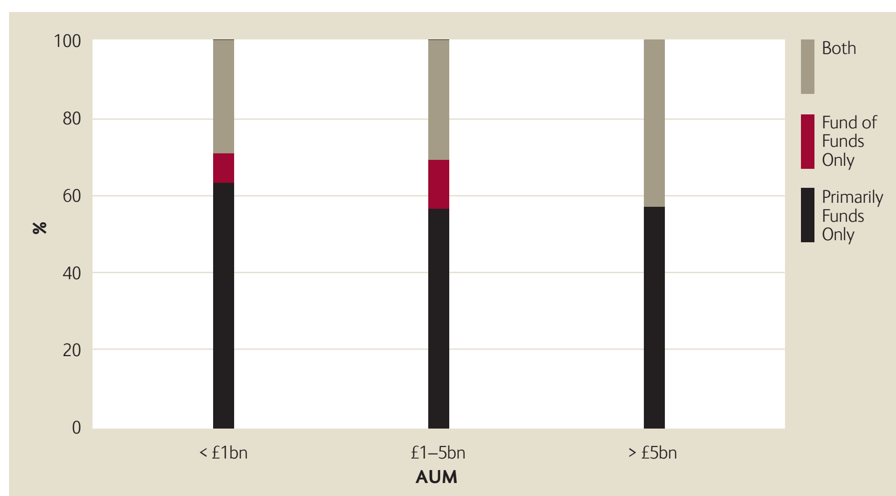


Figure 27: LPs' investments with direct funds and fund of funds

It is notable that many of LPs that focused exclusively on funds of funds were public pension plans, accounting for four out of only six such investors.

Q14: "Do you invest in listed private equity funds?"

Only 11 LPs out of the 100 sampled invest in listed private equity funds, confirming this sector as a minority interest among institutions at present. The UK is one of the most developed markets as regards listed private equity funds, and this is reflected in the relatively higher involvement of UK-based LPs in investing in listed funds: four of the 11 LPs investing in listed funds were from the UK (25% of the UK LPs polled), four were European (11% of the European LPs polled), and three were from the US (8% of the US LPs polled).

The LPs who do invest in listed private equity were spread across all sizes and types of LP, although it was noticeable that 4 of the 11 LPs investing in listed PE funds were themselves funds of funds, perhaps suggesting that these relatively sophisticated investors find these funds to be of interest.

Q15: "What percentage of your total PE portfolio does your UK investment currently account for?"

The majority of this global sample of LPs (59%) had 10% or less invested in UK-managed funds, but there were also significant proportions of LPs with higher levels of UK investment – 24% of LPs had between 10% and 19% invested in the UK, and 9% of LPs had between 20% and 29% in the UK, and a further 8% of LPs had 30% or more of their PE investments in the UK (please see Fig. 28).

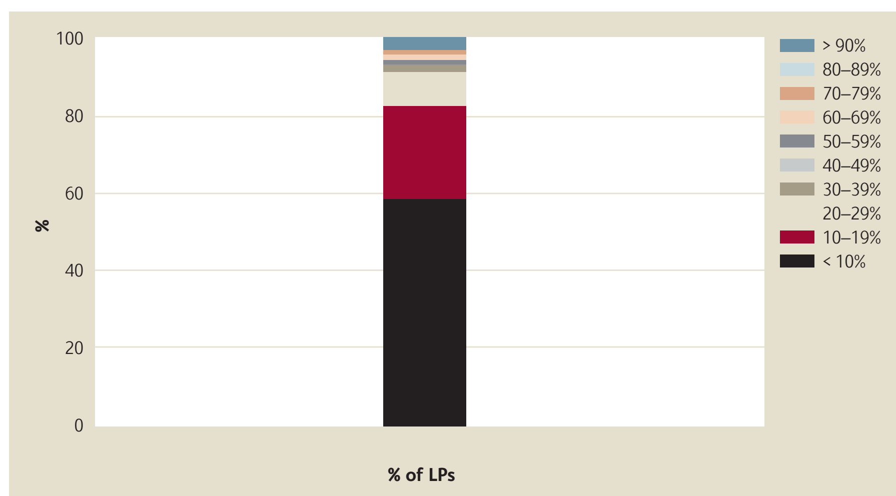


Figure 28: **UK investments as a proportion of LPs' entire PE portfolios**

As would be expected, the highest percentage levels of investment in UK private equity funds comes from among UK-based LPs, however it is notable that there are significant numbers of European and North American LPs who also have a large proportion of their total private equity investment in UK funds (please see Fig. 29). 27% of European (ex-UK) LPs had between 10% and 19% of their total private equity investments in the UK, with a further 12% of European LPs having between 20% and 29% invested in UK-managed funds. The pattern for North American LPs is similar, with 24% of the LPs polled having between 10% and 19% of their entire private equity portfolio invested in UK-managed funds, and a further 9% having between 20% and 29% in UK funds. The fact that UK firms have been able to attract such significant investments from European and US LPs is a credit to the industry.

UK-managed funds naturally account for a higher proportion of UK-based LPs' portfolios than for European or North American LPs, with 20% of those polled investing exclusively with UK-based firms.

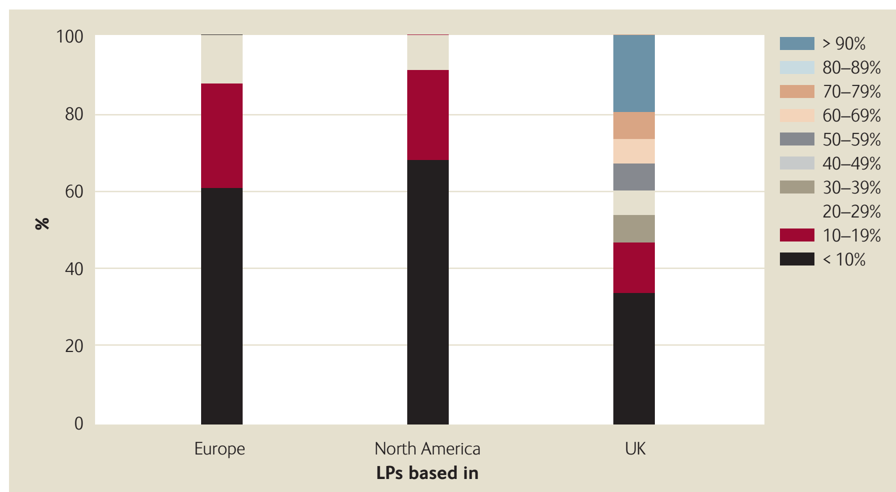


Figure 29: **UK investments as a proportion of LPs' entire PE portfolios vs. LP location**

Q16: "Is this (percentage of your total PE portfolio in UK funds) likely to change?"

We also asked LPs whether the proportion of their total portfolio invested in the UK was likely to change over the next 12 or 24 months. Relatively low proportions of the LPs surveyed though that any change was likely, with only 6% considering a change likely over a 12 month period, and 13% considering a change likely over a 24 month period.

Q17: "What resource do you use in selecting UK-based PE managers?"

This question mirrors Q12 above, but is specifically aimed at the resources used for making investment decisions in selecting UK-based PE managers, as opposed to setting the overall allocation to private equity as an asset class.

The majority of LPs claim to rely primarily upon their own internal resources (61% of LPs), or a combination of internal and external resources (21% of LPs), and only 18% of LPs claim to rely primarily upon external consultants. The use of external consultants appears to be highest in the UK and US, and is significantly less prevalent in Europe (excluding UK).

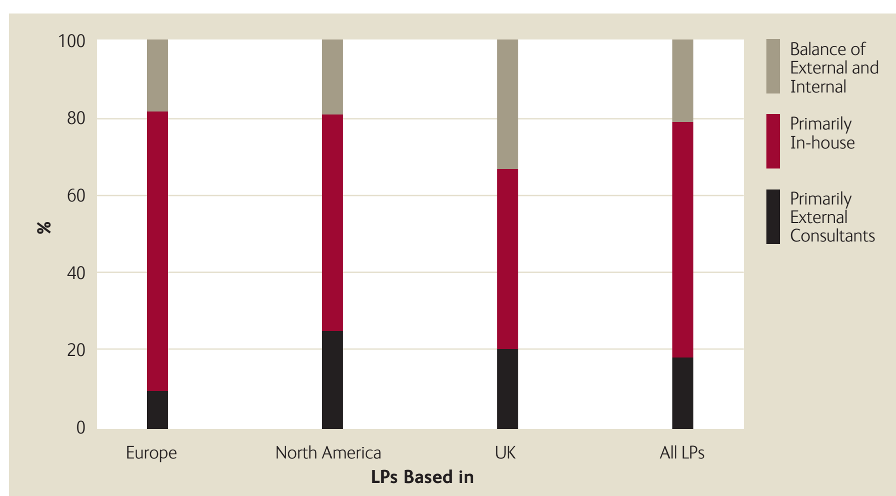


Figure 30: resource used in selecting UK-based PE managers

Q18: "What are your investment strategies for PE in the UK?"

This question was aimed at determining which types of funds investors focused on in their investments in the UK. LPs were asked whether they currently invested in this fund strategy in the UK today, whether they planned to do so in the future, or both.

This question was asked of LPs based in all regions, and the three charts below, Figs. 31 to 33, show the results for respectively all LPs, those LPs based in Europe (ex-UK), and those based in North America. There are several interesting implications from the answers to this question:

1. LPs clearly see the buyout segment of the market, and especially the mid-market buyout segment, as being areas of strength for the UK, and include this within their investment strategies, both currently and for the future;
2. Secondaries are also an area of interest for LPs investing in UK funds, doubtless this is a reflection of the pre-eminent position of leading UK firms in this market;

3. Other fund categories (venture capital, distressed debt / equity, rescue / turnaround and real estate) may feature less prominently in LPs' plans as regards investing in UK funds, but still score well on an absolute basis, with between 30% and 50% of LPs including these areas in their plans for investment in the UK, either currently or prospectively for the future;
4. It is noticeable that North American LPs rate UK funds highly under the category of "Not today, but in the future", so this augurs well for the UK industry's prospects for attracting additional future investment from US-based LPs. Given that the survey included views from 38 North American LPs, these positive findings can be regarded as being robust;
5. Conversely, European LPs include UK funds in their existing private equity investments to a generally higher extent than do their North American counterparts, but the proportion of LPs who answered positively under the "Not today, but in the future" heading is correspondingly lower. This suggests that the scope for gaining increased levels of investment from European LPs may be lower than it is from North American LPs.

We view these findings as encouraging, as they indicate the potential for the UK private equity industry to attract increased levels of investment from North American LPs.

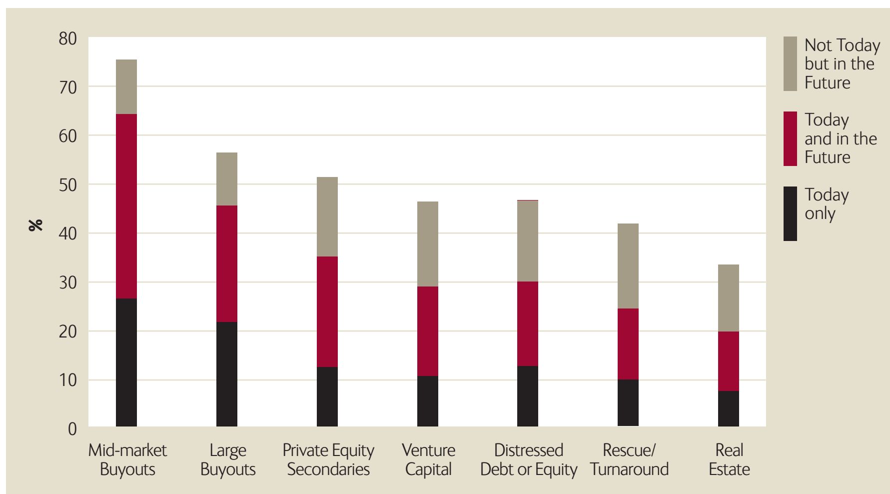


Figure 31: LPs investment strategies for PE in the UK

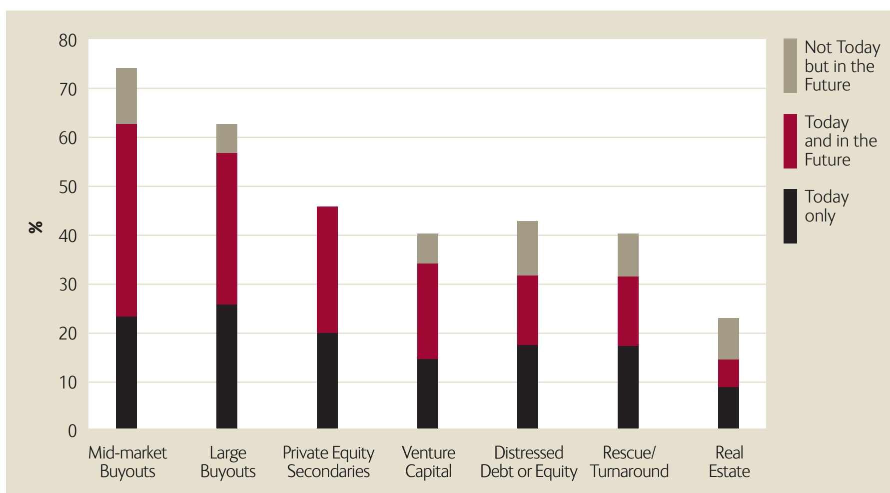


Figure 32: LPs investment strategies for PE in the UK - European LPs

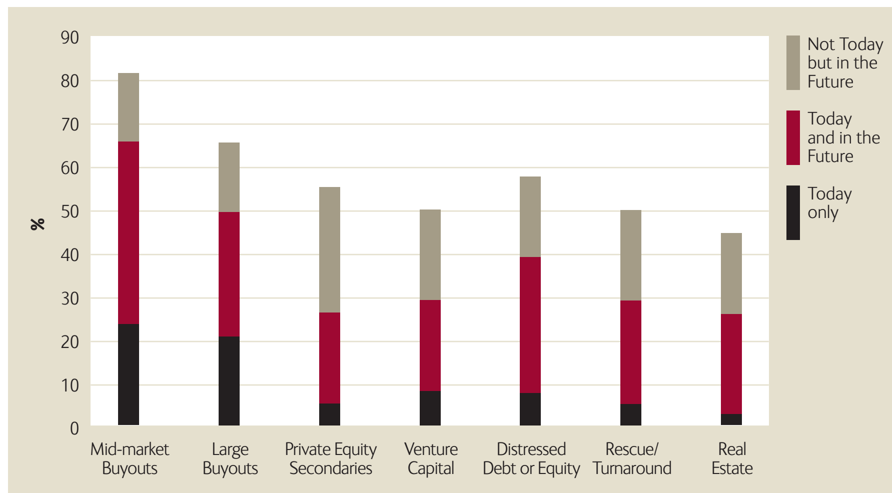


Figure 33: LPs' investment strategies for PE in the UK - N. American LPs

Q19: "Are your investment strategies for the UK different to those for the other geographic regions?"

This question explores whether the answers to the previous question (18) reflect LPs pursuing a consistent investment strategy across all regions (including the UK), or whether they reflect LPs focusing upon what they consider to be particular areas of strength in the UK private equity industry.

85% of LPs responded that their investment strategies in the UK were the same as those in other regions, but 15% said that their strategies in the UK were different. The survey included views from a total of 100 LPs, so the 15 positive responses are a small sample on which to base a statistical analysis, but it may be helpful to list some of the comments that LPs gave:

- *"We focus our venture investments in the US";*
- *"We feel some strategies, e.g. large buyouts and secondaries are best pursued on a pan-European or global basis. Other areas, such as venture, are not ones in which the UK excels in our view";*
- *"Heavier weighting towards buyout than venture versus the U.S. Market for venture is not good";*
- *"Growth capital and quasi venture emphasized more elsewhere";*
- *"Different opportunities and managers in different locations";*
- *"Will not consider UK venture capital"*
- *"Due to buyout nature of UK PE industry"*

Q20: "How did your investment in private equity funds managed by UK-based private equity firms perform relative to your investment in other regions in the past five years? "

LPs were asked to rate whether their investments in funds managed by UK firms had performed much better / somewhat better / etc. than their investments with US firms, European firms and emerging markets firms. The results are shown in Fig. 34 below.

The first point to note is that the performance differences between funds managed by firms in the different regions are relatively modest in nature. There are better and worse firms based in each region, so that some LPs will have had good experiences with firms from a particular region, while others will have had bad experiences.

However, subject to this overall caveat, it is noticeable that the comparison of UK vs. European firms is reasonably symmetrical, in other words, UK and European firms' funds appear to have performed broadly similarly for their LPs. However, the comparison between UK and US firms and between UK and emerging markets firms is somewhat skewed against the UK firms, in that the LPs' experience has been that the funds managed by UK firms in which they have invested have somewhat under-performed those of US and emerging markets managers.

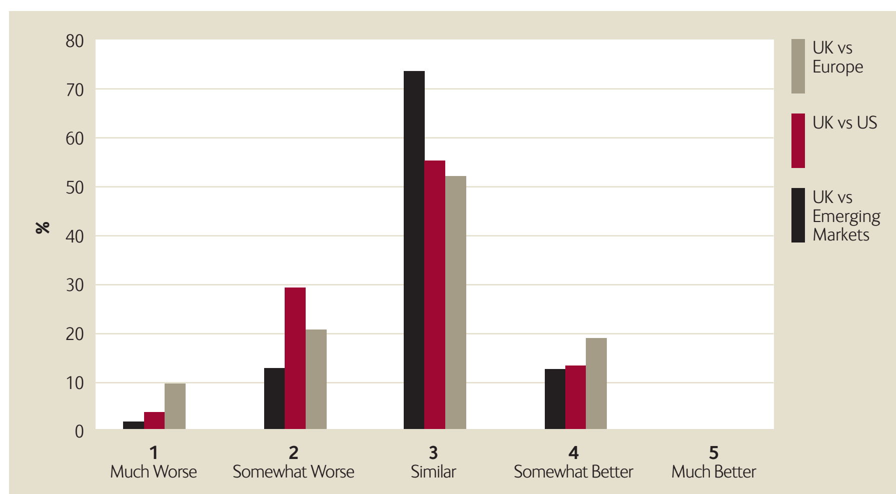


Figure 34: Performance of LPs' UK PE investments relative to those in other regions

This can be further illustrated by calculating the average score for each region – i.e. giving a score of 1 for 'much worse', 2 for 'somewhat worse' etc., one can compare the average UK score against other regions. If the regions have performed similarly, they will score 3.0, whereas if the UK is perceived to have performed worse than another region, then its score will be below 3.0. The average scores were as follows:

- UK vs. Europe: 2.97
- UK vs. US: 2.77
- UK vs. emerging markets: 2.80

This confirms the intuitive impression from the graph in Fig. 34: LPs investments in UK funds have performed similarly to those with European managers, but to have somewhat underperformed relative to their investments with US managers and emerging markets managers.

It is important to emphasise here that this finding relates to the experience of the LPs interviewed, which may or may not correspond to the reality of actual performance for all LPs. However, it is instructive to look at how the experience varies among LPs based in each of the main different regions. The results are shown in Fig. 35 below:

- Funds managed by UK firms are generally considered to have performed similarly to those managed by European firms, with the exception that LPs based in Europe consider the UK funds to have performed somewhat less well;
- Funds managed by UK firms are generally considered to have performed less well than those managed by US firms (although the margin of under-performance was considered to have been less significant among European LPs); and
- Funds managed by UK firms are generally considered to have performed less well than those managed by emerging markets based firms, other than among North American- based LPs, who considered the UK funds to have performed similarly.

Views of LPs based in:	UK vs. Europe	UK vs. US	UK vs. Emerging Mkts.
European LPs:	2.88	2.90	2.76
N American LPs:	3.04	2.67	2.95
UK LPs:	3.00	2.71	2.67

Figure 35: **Average perceived performance of funds of UK managers vs. those of other regions**

Clearly these findings relate to LPs' perceptions and their own individual experiences, but there does appear to be at least a measure of consistency in these views. Whilst these findings may be of some concern to the industry, it is worth noting that the responses to a later question (23) confirm that LPs expect funds managed by UK-based managers to perform in line with the rest of their private equity portfolios.

Q21: "What is your expected IRR for PE over the next five years (net of fees and carried interest)?"

LPs were asked to give their expectation for net IRRs over the next five years, selecting from multiple choice answers in the ranges of a. <5%, b. 5 – 10% etc.

The results are shown in Fig. 36 below. A high proportion of LPs expect net returns to be either in the range of 10 – 15% (38% of all LPs), or in the range of 15 – 20% (37% of all LPs). 8% of LPs are expecting net returns in the range 5 – 10%, while a proportion of LPs (16%) are anticipating net returns in the range 20 – 25%.

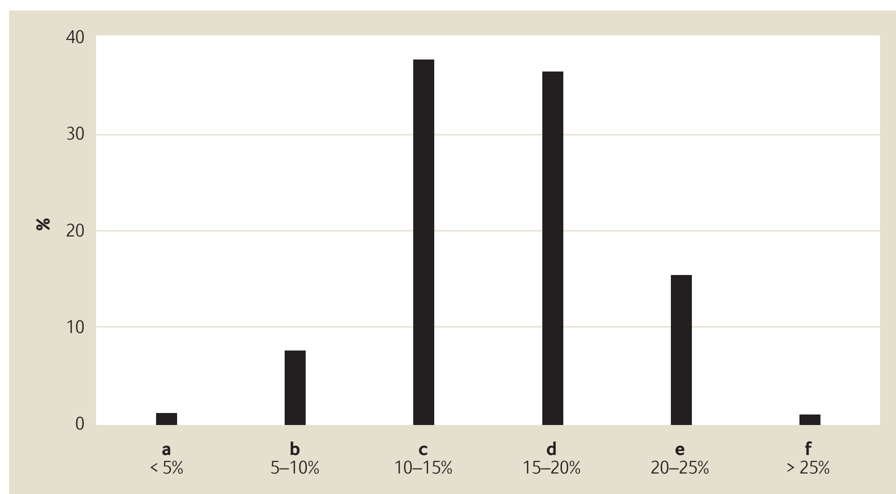


Figure 36: **LPs' expected net return from PE over next 5 years**

The approximate average net return expected by all LPs is 15.6% (taking the mid-point of each range). The expectations of LPs based in different regions are broadly similar, although there are some modest differences as follows:

- European LPs: 15.1%
- US LPs: 16.1%
- UK LPs: 16.6%

(The net returns expected by LPs from the rest of the world were generally somewhat lower, although the sample sizes here are too small to draw any firm conclusions).

Q22: "How does this compare with the previous five years?"

LPs were asked to compare their expectations for net IRRs for the coming five years with those which they have experienced over the previous five years, and to rate them as the same or better / worse in bands of 500BPs net.

The results are shown in Fig. 37 below; there is quite a wide range of expected returns, reflecting at least in part the inherent uncertainty of the investment environment. However, there is a discernable downwards bias in expectations, with 35% of LPs expecting future returns to be lower, compared with 24% of LPs expecting net returns to be higher. 41% of LPs expect future returns to be similar to the recent past.

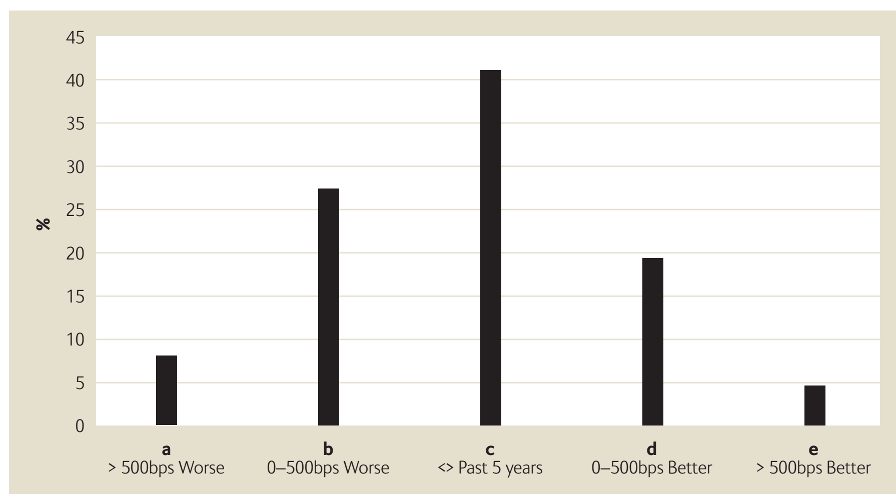


Figure 37: LPs' net IRR expectations for coming 5 years compared to past 5 years

On average, it appears that LPs are expecting net IRRs over the coming five years to be approximately 45 BPs lower than they were over the past five years.

Q23 and 24: "Is your return expectation for UK-based PE funds different to this?"

The responses to this question were clear-cut, with an overwhelming majority of LPs (96% of those who gave a response) stating that their return expectations from UK-managed funds were the same as their expectations generally.

This is encouraging in the context of the findings from Question 20, which indicated that LPs' felt that the historic performance of their funds managed by UK firms had lagged somewhat behind those managed by US- and emerging markets-based firms.

Q25: "Historically funds raised during economic downturns have often produced superior returns. Do you believe the 2008/09/10 vintages will generate strong returns?"

This question addressed the very topical issue of whether or not LPs subscribe to the view that the current challenging economic times represent a good opportunity to invest in private equity, given that fund vintages which have their investment periods in difficult economic times often deliver good financial returns.

The encouraging news for the private equity industry is that 87% of LPs agree with this statement, and expect the 2008 – 2010 vintages to generate strong returns, as opposed to only 13% of respondents who disagreed with the statement. Furthermore, 94% of the total sample of LPs felt able to answer this question, so the answers carry a strong measure of conviction.

This confidence in the likely returns from 2008 – 2010 vintage funds is consistent with the findings from other questions in the survey, most notably question 6, where most LPs stated that they intend to maintain their allocations to private equity, and among those that plan to change them there was a clear majority planning to increase allocations over a two-year time horizon. Taken together, these findings suggest that LPs continue to invest significant amounts of capital in the asset class.

Responses to Open-Ended Questions

Q1: "Are there any restrictions in your mandate in terms of allocations to private equity?"

Most investors who responded to this question stated that they do not have any restrictions in their private equity mandate. While most LPs have target allocations for private equity, many of them consider these to be more of a guideline than a restriction, as there is typically room to increase the target once it has been reached. Investors are also able to continue making new investments when they have reached their targets in order to maintain their allocations. However, a number of LPs view their hard-cap for their target allocations as a restriction. Some LPs have recently reached their hard-cap target allocations, and are unable to commit any further capital into the asset class at present. One US-based endowment plan stated, "We do not really have any restrictions other than a target allocation to the asset class. We are currently over allocated to private equity as a result of the denominator effect, so have scaled back on our investments for the time being."

Most investors do not have restrictions in how they choose to invest their capital in the asset class. Many respondents indicated that they have established their own parameters for their private equity investments; they have selected the fund types and geographical regions in which they prefer to invest, because they believe these can provide them with the highest returns. Most investors are also able to adapt the guidelines they have put in place for themselves, to correspond with evolving market conditions. Investors may also decide to avoid certain regions or fund types, as they have limited knowledge of them. In addition, some institutions do not follow guidelines (self-imposed or otherwise), but chose to invest on an opportunistic basis. One investor stated that they believe private equity to be attractive to investors because of its flexibility.

Among those LPs that do have restrictions in their mandate, the most common limitations appear to be on fund type and geography. For example, one government agency said they are only permitted to invest in funds focused on their own country, to match their economic development mandate. Other institutions are focused on promoting economic and social development in emerging economies, and are only permitted to invest in these countries. One Swiss private equity funds of funds manager told us, "We have geographical restrictions. There are 25 countries we are permitted to invest in, and all of them are emerging markets." Conversely, many investors are only able to invest in vehicles focused on established markets, as they view emerging markets as too risky. Some LPs are restricted to the particular fund types and regions in which they have experience. Many smaller public pension funds and family offices invest in the asset class only through funds of funds, as they do not have enough staff to focus on making direct investments into private equity funds.

Q2: "Do you feel able to comment on strengths of UK managers in comparison to those located in other regions?"

Many of the LPs interviewed felt unable to comment on the specific strengths of UK managers when asked to compare them with GPs located in other regions. It appears that most LPs do not differentiate their UK private equity investments from their overall European allocation to private equity, viewing the UK as part of their allocation to Europe.

Most LPs stressed that they place more emphasis on the quality and strengths of individual managers, without regard to where the GP is located. The priority for the vast majority of LPS is the strategy of the fund and the management team managing the fund, often assessing this on a case-by-case basis.

One German-based funds of funds manager said, "We do not invest in funds that concentrate on specific regions, as we prefer a broader approach. We look to access top quartile funds, and so if a manager is able to provide this, then we will look at the fund."

Q2a) i: "If No: What are your views on the strengths of European vs. US-based GPs?"

As in the previous question, many of the LPs interviewed felt that it was difficult to make any meaningful general statements about GPs in one region as compared to another. Most LPs felt that strengths and weaknesses vary from manager to manager. Many LPs emphasised that they do not seek managers based on their location; they make judgements on the quality of each individual firm.

However, some LPs felt they could compare European and US-based managers and discern some general patterns. Some described European firms as being more flexible than US-based managers; and as the European firms can invest across a wider range of countries, they offer more geographic diversity to an LPs investment portfolio.

Many LPs also said that, due to the nature and origins of the private equity industry, US fund managers tend to be more experienced and have stronger track records. Some LPs also stated that US GPs have historically performed better than their European counterparts. A Danish insurance company also felt that US-based GPs were slightly stronger in their skills in improving the profitability of portfolio companies, while another LP went on to say that US managers are slightly more dynamic than European firms. One LP stated that US firms tend to be more operationally driven, whereas UK and European GPs tend to focus more on financial structure.

One LP stated that in the past twelve months their European investments have performed better than their US portfolio. A Finnish LP also said that "European GPs have a higher level of competence than GPs in other regions," and this sentiment was echoed by a US-based public pension fund who felt that European managers perform very strongly and are of "high quality".

We have attempted to draw out some of the flavour of LPs' responses to this question, but the most consistent theme is the one we started with: most LPs do not feel able to comment on differences between European and US-based GPs, as they felt that there were many similarities between the two, and the critical factors are the skills and strategies of each individual firm.

Q2b) i: "If Yes: What are the strengths of the UK-based GPs relative to those based in other European countries?"

Again, many LPs felt that it was impossible to judge GPs on solely location. The performance of a GP is assessed on an individual basis and the strengths of the team rather than on the region in which they are located. Quite a few LPs also said that they did not differentiate their UK allocation from their overall European allocation, and were therefore unable to comment on the strengths of UK GPs.

A small number of LPs were able to make more general statements about the strengths of UK-based GPs in comparison to their European counterparts. One of the most common responses was that the UK private equity market is the most advanced in Europe, and therefore has managers with a lot of experience and proven track records. One LP also said that the GPs in the UK have experienced more economic cycles than managers in other countries within Europe, and this puts them in a stronger position in terms of experience.

A large Japanese-based insurance company thought that the UK market was very sophisticated and UK-based GPs tend to be more structured than their European counterparts. The firm thought that this could be both an advantage and a disadvantage.

The proximity to London, which is considered the financial centre of Europe, and consequently the easier access to banks as well as the strengths of relationships with financial institutions, was also thought to be an advantage for UK firms over European managers. Overall, it was felt that the UK has a better financial infrastructure compared to other countries in Europe so therefore UK-based GPs have an advantage in this respect.

A large Canadian public pension fund said that it was difficult to compare UK GPs to all European ones, as certain countries within Europe are more developed than others. The LP said that the private equity industry in France, for example, is more developed than Germany, Italy and Spain, and that it was therefore difficult to generalise across the region.

Q2b) ii: "Similarly, what are the strengths of the UK-based GPs relative to those based in the US?"

As with the other questions relating to the strengths and weaknesses of GPs in different regions, most LPs felt that they could not comment on this question. The emerging theme is again that it is the strengths and skills of individual firms that matter most.

Some LPs commented on the similarities between the UK and US industries, and said that they could not really distinguish between the two. LPs generally feel that the US and UK private equity market are the most advanced in the world, and therefore the top performing managers are found in these regions.

A large Japanese investment bank said that one of the main attractions of UK private equity is that it is a combination of both US and European characteristics. A US-based funds of funds manager said that the quality of UK-based GPs was generally superior to US fund managers. Another LP told Preqin that US managers are often more generic and sector focused than UK GPs. An Austrian funds of funds manager said that US-based managers tend to raise larger private equity funds, have been active in the asset class for longer, and are therefore more experienced than UK GPs.

Q3: "What are the key obstacles preventing you from allocating more to the UK private equity industry?"

The most common obstacle preventing LPs from allocating more to the UK private equity industry is the need to diversify geographically. Investors in private equity typically aim to build diverse portfolios by fund type and geography in order to lower their risks, so therefore seek to invest their capital in a variety of regions. Some institutional investors set target allocations for each region in which they seek to invest, as this prevents them from becoming over-exposed to one specific country or region.

One respondent explained that their allocations for each region are affected by the size of the market; he said, "The size of the market prevents us from allocating more to the UK. Our private equity investments are a reflection of the nature of the market, i.e. we invest more in the US as it is a bigger market." Several LPs also expressed their desire to match their investments to the size of the opportunity in each market.

Many investors stated that internal resource constraints prevent them from allocating more to specific UK-focused funds. They do not have enough resource to focus their investments on a specific country such as the UK, so prefer to invest their capital in funds with a broader geographic focus, e.g. European or North American focused private equity funds.

Market knowledge and access are also issues for many LPs. One European private equity funds of funds manager told us, "Access to good fund managers is also an obstacle for us - we always look to invest in the best fund managers and we do not always have access to those in the UK but we do in other European countries."

However, many respondents feel there are no obstacles preventing them from allocating more to the UK private equity market, and are able to continue investing more capital into UK private equity funds going forward. One US endowment plan said, "We do not feel that there are any obstacles preventing us from allocating more to UK private equity. We currently have a substantial amount of capital invested in UK private equity, and we will continue to invest further capital into the UK." Several LPs have recently reached their target allocations to private equity so do not currently have any capital available to invest anywhere, but informed us that they are likely to recommence their investments in the asset class in the next 12-24 months.

Some investors said they are holding off from investing in the UK as the current exchange rate is not favourable, but will continue to invest in the UK when the exchange rate is beneficial for them.

Q4: "What do you think the GPs should do in the current climate to build long term relationship with the LPs?"

Better communication and greater transparency are the two key improvements LPs would like to see from fund managers. LPs feel that in the current economic climate it is vital that GPs ensure they keep LPs informed about how their investments are performing and give regular updates on the performance of portfolio companies. Several LPs commented that they would prefer to hear directly from the fund manager about investments that have performed badly, rather than learning about these through the media. Regular reporting on present and future deal flow is also encouraged in order to ensure that the LP has access to as much information as possible. Emphasis was also put on the need for an improvement in the quality of data provided and the way in which it is presented to the LP.

Another key point that emerged from the survey is that LPs would like to see a better alignment of interest between the GPs and LPs. Some LPs would also like to see GPs committing a larger percentage of the fund's total equity to their funds in order to instil confidence in LPs.

Related to this, some LPs also commented on wanting to see improved fund terms and conditions. Many said that they would like to see a reduction in management fees, while one LP said, "carry should make a fund rich, not the management fee". A Danish

pension fund highlighted their concerns about 'key man' and 'no fault divorce' clauses being in favour of the GPs, with LPs having little influence over this. LPs would also like GPs to report net rather than gross so that LPs get an idea of the real performance of their investments.

A European bank said that they would like to see GPs working harder for their returns. This LP believes that private equity has been very lucrative in the past 5 years because of the easy access to leverage, but this is not the case anymore. LPs would like to see fund managers taking a more pro-active approach and working closely with portfolio companies in order to maximise returns in the current economic climate. They should work hard to preserve the value of their portfolio companies and should strengthen the position of these companies. (It must be acknowledged here that most private equity firms are placing greater emphasis on operational matters, so these comments relate to the perceptions of the LPs surveyed, and indicate the need for effective communications.)

Some LPs would also like to see more co-investment opportunities so that they are able to have more input and influence on their underlying investments. A number of LPs feel that GPs do not consult them enough about investment decisions and they feel that there is some 'arrogance' amongst GPs.

"Back to basics" was a common theme that emerged from LPs when they were asked about what GPs should be doing in the current financial climate. Some LPs feel that some GPs are trying to diversify too much and are not concentrating enough on ensuring that "their value generation model works well". GPs should also avoid trying to raise funds that are too large; instead they should focus on identifying the best investment opportunities and maximising returns.

LPs also believe that as the private equity market is currently going through a quiet period with many GPs not fundraising at the moment, they should use this time to meet with LPs so that they are able to establish relationships with them for forthcoming funds. Many LPs told Preqin that they have more time to meet with GPs, because a lot of them have put their investments on hold and have more time to think about where they are going to allocate capital when they do come back to the private equity market. They would like to see better pre-marketing efforts by GPs, so that investors have time to assess the opportunities they are presented with, well ahead of the start of fundraising.

A small number of LPs are satisfied with the way GPs appear to be conducting themselves, especially UK GPs. They are finding that a lot of them appear to be travelling around the world to meet with potential investors, with one Japanese LP telling Preqin that UK GPs frequently travel over to Tokyo and present them with information about forthcoming funds and the teams' history, helping establish better relationships. LPs appear to be impressed with GPs that take the time to meet with them, even though they are not actually fundraising at present - this has helped them get to know the team better, and has meant that they are better informed before deciding to commit to a forthcoming fund. Improving investor relations seems to be the key to building long term relationships with LPs.

Q5: "What do you think BVCA can do in helping its member firms to demonstrate to the LP community that UK PE is a good place to invest?"

"As long as GPs are providing high quality information to LPs, there will be continued interest in UK private equity". This was one of the strongest messages that came from asking LPs about what could be done to encourage LPs to invest in UK private equity. The majority of participants said that they are result oriented, so better reporting by fund managers on the performance of their investments may increase interest in UK private equity.

LPs need to be made aware of the opportunities and reasons why UK private equity is a good place to invest. Investors would like the BVCA to encourage its member firms to communicate more with LPs and share information. A number of LPs told Preqin that GPs should be encouraged to provide data on past performance of UK private equity funds. By making information on UK private equity more readily available, LPs will be more aware of the opportunities that are on offer. One UK-based investment trust thinks that the BVCA should collect more information from member firms and present the LP community with quarterly updates or research reports. The reason for this was that "GPs are usually biased, so it is a good idea to have a neutral party providing the LP community with information on UK private equity".

LPs also feel that the BVCA should encourage its member firms to increase transparency. LPs want the BVCA to encourage GPs to work on governance, transparency and regulation issues. Many also want to see the promotion of 'good standards' amongst GPs and would like to see member firms acting according to these benchmarks. Clearer guidelines on valuations of portfolio companies are another area LPs feel the BVCA can improve on.

Several LPs made comments on individual situations, the common theme of which was their perceived need for more communication on individual firms and the UK industry in general:

- A Danish foundation said that as they are small investors in private equity, they do not have the resources to carry out in-depth research on GPs located around the world, and therefore would benefit from documentation explaining the advantages and disadvantages of investing in UK private equity. The foundation also said that they would benefit from documentation that compared the performance of UK private equity with other regions, so that LPs would be in a position to make a more informed decision.
- A Finnish insurance company said that marketing the advantages would prove to LPs that "UK private equity fund managers are doing their jobs properly".
- An Arizona-based public pension fund said that the BVCA should demonstrate solvency of the banking system and the stability of UK currency to encourage people to invest in the region. It should also be able to demonstrate that there are 'good growth prospects' in the UK private equity market.

A number of LPs felt unable to give a specific answer to this question, as they felt the BVCA were already good at demonstrating that UK private equity is a good place to be investing and could not suggest any further improvements:

- A Denmark-based insurance company told Preqin that he felt that the BVCA is one of the better organisations at demonstrating that the UK private equity industry is a good place to invest. The LP said that the BVCA should continue to market the advantages to LPs and continue the good job they are doing.
- A US-based funds of funds manager said that the BVCA should continue to be an advocate for private equity. They also thought that the BVCA should participate in academic work that examines the role of private equity and how it creates value.

Others felt that it was not the BVCA's role to persuade LPs to invest in UK private equity. They believe that it is a decision that LPs should make on their own, based on performance of UK private equity funds. However, it was said that perhaps the BVCA should encourage its member firms to address LP issues, such as the alignment of interests between GPs and LPs.

Q6: "What are your views on the European Commission's Draft Directive in its current form on Alternative Fund Managers?"

Many participants (especially those from the US) stated that they are not familiar with the European Commission's Draft Directive, so were unable to express any views on it.

However, the majority of those LPs that are aware of the Directive have very strong views about it, as they feel that it is unnecessary and does not offer additional protection to investors in its current form. A significant portion of investors indicated that they think it is too broad, as it is aimed at hedge funds managers too. One US-based funds of funds manager said, "The Directive is not very relevant for the private equity community. It is more targeted towards hedge fund managers so should not be applied to private equity as well." The common perception from those LPs that have read the Directive is that it needs to differentiate between private equity and hedge funds, as there are too many differences between the two asset classes to provide them with the same Directive to follow. Several LPs feel that the reason it is not suitable is the result of it not being written by private equity industry professionals. One UK private sector pension fund said, "We think the initial intention behind it was good but it is unnecessary for the private equity industry. It has not been drafted by specialists so it is not entirely relevant."

Several respondents expressed that they are happy with the private equity industry and trust the fund managers in which they invest, so do not feel that a Directive in any form is necessary. A Danish private equity funds of funds manager said, "We feel that a

Directive is not necessary and we struggle to see the added value of it from an LP perspective. We doubt that it will have significance on future development, and feel that it will be expensive to ensure that they are compliant with the new rules." A number of LPs feel that putting rules and regulations in place is not necessary for the private equity industry; a Canadian public pension fund told us, "We think it is important not to be too bureaucratic as this could have a negative effect on private equity."

However, some participants felt that although the Directive in its current form is unnecessary, the intention behind it is good, as it has been put in place to protect investors. They feel there is a lack of transparency among alternative fund managers, which a considerable number of investors do find to be a problem that needs to be addressed. Some LPs feel that the Directive may improve the levels of transparency. One Finish government agency said, "Although we know that a lot of LPs do not think it is necessary, we think that the private equity market needs to become more transparent, so on the whole it is justifiable."

Q7: "Do you see the tax environment in the UK for Private Equity changing in the medium term?"

A significant 47% of participants were unable to comment on the change of the tax environment in the UK for private equity in the medium term. This was because the majority of respondents for the survey are not based in the UK, and many are therefore unaware of the UK tax regulations. Some LPs were able to make assumptions based on what has been happening in the overall private equity and financial markets. 35% believe that there will be changes in the UK for private equity taxation, while 5% feel that there is a possibility that this will happen. Only 13% said that they do not expect any changes in the medium term.

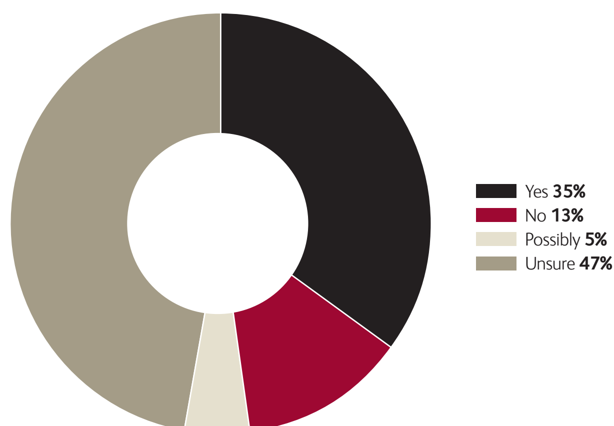


Figure 38: Do you see the tax environment in the UK for Private Equity change in the medium term?

Q8: "If the answer for Question 7 is yes, in your view, how will the change impact on":

a. **"The motivation of the UK-based managers and on your return?"**

None of the LPs Preqin interviewed felt that prospective changes in the tax environment in the UK for private equity would have a positive effect on the motivation of UK-based managers or on LP returns. 52% thought that the effects would be likely to be negative, while 48% were not sure whether a change would have a positive or negative impact.

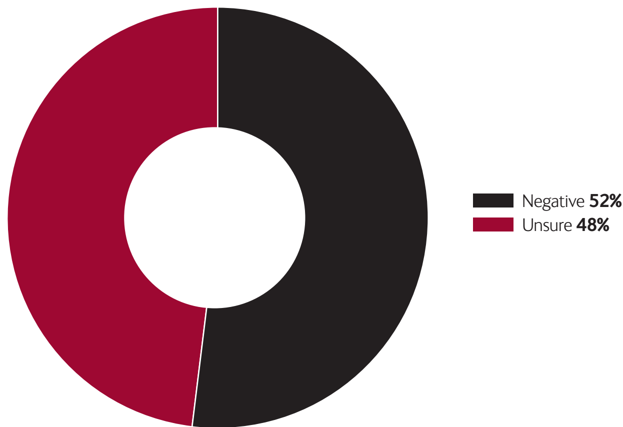


Figure 39: **How will a change in the tax environment for UK private equity impact on the motivation of the UK-based managers and on returns?**

b. **"Your return on Private Equity investment?"**

Similarly, none of the LPs we questioned felt that prospective changes in the tax environment in the UK for private equity would have a positive effect on their private equity returns. 52% thought that it would have a negative effect, and 48% were undecided as to whether a change in the UK tax environment for private equity would have a positive or negative impact.

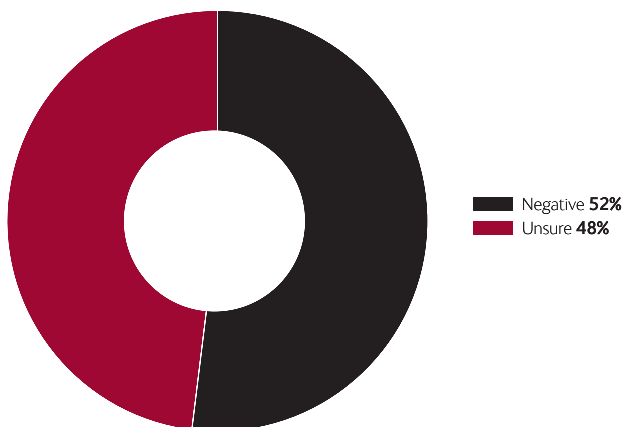


Figure 40: **How will a change in the tax environment for UK private equity impact on your return on Private Equity investment?**

Q9: "What do you expect from GPs re the ESG issues (environment, social and governance)?"

The majority of investors indicated that, although they would like GPs to take environmental, social and governance issues into consideration, they do not expect them to sign up to UNPRI or any other equivalent standards. LPs are generally more interested in committing to GPs that can create high returns for them, rather than those that are focused on following UNPRI guidelines or other equivalent standards. Some LPs feel that these standards can create inflexibility and can restrict them when making investments. One US endowment plan told us, "We think GPs are under pressure to sign up to UNPRI but we are not aware of the benefits of signing up to this. We are interested in maximising returns and do not want to be handcuffed in any way." Several investors suggested that GPs should automatically be taking these issues into consideration without having to sign up to UNPRI or other standards. A US foundation said, "We think GPs should not have to sign up to such standards. Those GPs that are making investments without taking the ESG issues into consideration are not making good investments, and LPs should see that. Those GPs that do sign up are using it as a way of marketing themselves."

A significant number of respondents stated that although they think GPs do not need to sign up to UNPRI or other equivalent standards now, over the next few years it will become of increased importance to follow guidelines in regards to ESG issues. As competition for LP commitments amongst GPs increases, those following the best practise will be more desirable to LPs and will hold a competitive edge over those that are not signed up to such standards. One Danish insurance company told us, "We expect that more GPs will sign up to UNPRI and it may eventually become a requirement that we impose for the fund managers that we invest with." Several LPs also informed us that although they do not expect GPs to sign up to UNPRI, they should do so if this is requested by the LP as it is important to take the LPs own policies and requirements into consideration.

A smaller proportion of investors informed us that they do expect GPs to be following guidelines in regards to environmental, social and governance issues, and they should be signing up to UNPRI or other equivalent standards. These LPs feel that GPs need to prove that they are investing the capital committed by them responsibly as it is an important factor for them and they may have their own investment guidelines they have to abide by. Several respondents indicated that they feel it is necessary because all GPs should be following the same guidelines and have a common understanding when making investments. One UK private sector pension fund told us, "We feel it is very important for GPs to sign up to UNPRI or other equivalent standards. There needs to be a level playing field across all companies and managers they invest in, it is not fair if certain asset classes have to follow a set of standards and others do not."

Q10: "Is there any feedback or comments you would like to express to the BVCA?"

Many LPs felt that they had already given feedback and made comments to the BVCA when answering question 5.

As mentioned previously, LPs would like the BVCA to produce more research reports in order to keep the investor community informed about the performance and opportunities available. They would like to see more data on UK private equity that is readily available and easily accessible to LPs. This would be especially beneficial for investors who do not have any exposure to UK private equity.

Some respondents said that they would like to see the BVCA take a more active approach in marketing the UK private equity industry, and would like to see a true picture of the industry, i.e. the strengths and the weaknesses.

Appendix 1

The 2009 BVCA–Preqin Survey into Global Investor Attitudes to Private Equity in the UK.

For the purposes of this survey Private Equity (PE) is used as a generic term describing investments in the form of equity in private companies, including Venture Capital (VC) investments.

CLOSED END QUESTIONS

Section 1: Information About Your Fund/Office

1. What are your total assets under management?
   Currency / Value
2. How long has your fund /office been investing in PE/VC?
   Years
3. How many full-time investment professionals are managing your fund or making investments for your office?
4. How many full-time investment professionals are managing your private equity portfolios?

Section 2: Your Allocation in Private Equity

5. What is your target allocation to Private Equity?
   Currency / Value / Percentage of Total Assets
6. Are you looking to change your target allocation to Private Equity:
   a. In the next 12 months?
      Yes, increase/ Yes, decrease/ No
   b. In the next 24 months?
      Yes, increase/ Yes, decrease/ No
7. If your answer for Q6 is yes, could you explain why?
8. Are you currently seeking new investment opportunities in Private Equity?
   Yes / No
9. Is your PE portfolio currently:
   a. Below target allocation
   b. At target allocation
   c. Above target allocation
   d. No defined target allocation
10. a. Do you have target allocations for the following regions: Europe (incl. UK), UK, US, Emerging Markets
      Yes / No
    b. If yes, please detail the percentage of allocation for each category:
      Europe (incl. UK)
      UK
      US
      Emerging Markets

11. How important are the following factors in influencing your decision on PE allocation?

    Please rate from 1 -5, 1 being not important at all, 5 being extremely important.

    a. Liquidity requirement
    b. Return potential
    c. Risk diversification
    d. The level of experience and knowledge in PE of your investment team
    e. Recommendation of your investment consultants
    f. Other
    Please specify: ....

12. What resource do you use in determining PE allocation?

    a. Primarily external investment consultants / gatekeepers
    b. Primarily in-house expertise
    c. Balance of internal and external expertise

13. Do you invest:

    a. Only in primary Private Equity Funds?
    b. Only in Private Equity Funds of Funds?
    c. Both in primary funds and funds of funds?

14. Do you invest in listed private equity funds?
    Yes / No

Section 3: Your Private Equity Investments in the UK

15. What percentage of your total PE portfolio does your UK investment currently account for?

    a. Less than 10%
    b. 10-20%
    c. 20-30%
    d. 30-40%
    e. 40-50%
    f. 50-60%
    g. 60-70%
    h. 70-80%
    i. 80-90%
    j. 90-100%

16. Is this likely to change:

    In the next 12 months?
    Yes / No

    In the next 24 months?
    Yes / No

17. What resource do you use in selecting UK-based PE managers?

    a. Primarily established investment consultancy firms / gatekeepers
    b. Primarily in-house expertise
    c. Balance of internal and external expertise

18. What are your investment strategies for PE in the UK?
    a. today / b. not today but in the future / c. both today and in the future

    Venture Capital
    Large Buy-outs
    Mid-market Buyouts
    Distressed Debt or Equity
    Real Estate
    Private Equity Secondaries
    Rescue/Turnaround

19. Are your investment strategies for the UK different to those for the other geographic regions?
    Yes / No

    If so why?

20. How did your investment in private equity funds managed by UK-based private equity firms perform relative to your investment in other regions in the past five years? Please select 1 – 5
    (1 being investment in private equity funds managed by UK-based private equity firms performing much worse than other regions and 5 being them outperforming other regions by far)

    UK vs Europe
    UK vs US
    UK vs Emerging Markets

Section 4: You return expectation for Private Equity

21. What is your expected IRR for PE over the next five years (net of fees and carried interest)?

    a. <5%
    b. 5-10%
    c. 10-15%
    d. 15-20%
    e. 20-25%
    f. >25%

22. How does this compare with the previous five years?

    a. More than 500bps worse
    b. 0-500 bps worse
    c. The same as current
    d. 0-500bps better
    e. More than 500 bps better

23. Is your return expectation for UK-based PE funds different to this?
    Yes / No

24. If you selected yes for question 23, what is your expect net IRR for PE over the next five years?

    a. <5%
    b. 5-10%
    c. 10-15%
    d. 15-20%
    e. 20-25%
    f. >25%

25. Historically funds raised during economic downturns have often produced superior returns. Do you believe the 2008/09/10 vintages will generate strong returns?
    Yes / No

OPEN ENDED QUESTIONS

1. Are there any restrictions in your mandate in terms of allocations to PE? Please discuss

   Triggers:
   a. Hard-cap for target allocation
   b. Regional / geographical restrictions
   c. Fund type restrictions
   d. Fund size restrictions

2. Do you feel able to comment on the strengths of UK managers in comparison to those located in other regions?

   a. If **NO**:
   i. What are your views on the strengths of European vs. US-based GPs?

   b. If **YES**:
   ii) What are the strengths of the UK-based GPs relative to those based in other European countries?

   a. Experience / quality of managers
   b. Geographical convenience
   c. Client reporting/Communication
   d. Track record
   e. Good investment infrastructure – experienced investment consultants, lawyers, advisors, etc.
   f. Responsible investment (e.g. more attention given to environmental, social and governance issues)
   g. Favourable tax/legal regime
   h. More solid regulatory framework
   i. Other (please specify)

   ii) Similarly, what are the strengths of the UK-based GPs relative to those based in the US?

   a. Experience / quality of managers
   b. Geographical convenience
   c. Client reporting/Communication
   d. Track record
   e. Good investment infrastructure – experienced investment consultants, lawyers, advisors, etc.
   f. Responsible investment (e.g. more attention given to environmental, social and governance issues)
   g. Favourable tax/legal regime
   h. More solid regulatory framework
   i. Other,
   please specify ....

3. What are the key obstacles preventing you from allocating more to the UK PE industry? Please rate from 1 – 5, 1 being not an obstacle, 5 being an extremely major obstacle.

   a. Already reached target allocation for Private Equity
   b. The need to diversify geographically
   c. Internal resource constraints; due to lack of specialist knowledge or lack of manpower
   d. Access to good fund managers
   e. Not certain about the level of alpha
   f. Other,
   please specify ....

4. What do you think the GPs should do in the current climate to build long term relationship with the LPs?

5. What do you think BVCA can do in helping its member firms to demonstrate to the LP community that UK PE is a good place to invest? Please discuss

6. What are your views on the European Commission's Draft Directive in its current form on Alternative Fund Managers?

    a. It is unnecessary and does not offer additional protection to investors.
    b. It is necessary and offers additional protection to investors.
    c. It is costly and burdensome for PE firms and their portfolio companies.
    d. It is easy for PE firms and their portfolio companies to comply.
    e. Don't know

7. Do you see the tax environment in the UK for Private Equity change in the medium term?
   Yes / No

8. If the answer for question 8 is Yes, in your view, how will the change impact on:

    a. The motivation of the UK-based managers and on your return?
       Positive / Negative

    b. Your return on Private Equity investment
       Positive / Negative

9. What do you expect from GPs re the ESG issues (Environment, social and governance)?

   Trigger: do you expect all your GPs signing up to UNPRI (Principles for Responsible Investment) or other equivalent standards?

10. Is there any feedback or comments you would like to express to the BVCA?

Appendix 2

BVCA

The British Private Equity and Venture Capital Association (BVCA) is the industry body and public policy advocate for the private equity and venture capital industry in the UK. The BVCA represents over 450 firms that are actively involved in the private equity and venture capital industry in the UK, Europe and the rest of the world.

The members are from venture capital, through mid-market to large buyout houses from across Britain.

The BVCA aims to improve understanding, clarity and transparency of the activities its members engage in whilst also promoting the private equity industry to entrepreneurs, investors, the Government, trade unions, the media and the general public.

Increasingly, the BVCA provides services and best practice standards for its members across a spectrum of activities covering a network of interconnected committees, which focus on segment-led, legal, technical, regulatory, investor-led and service-led needs. It also provides networking opportunities, training courses, research, publications, public affairs and communications on behalf of the industry.

www.bvca.co.uk **bvca@bvca.co.uk**

Preqin

Preqin is the leading source of information for the alternative assets industry, providing data and analysis via online databases, publications and bespoke data requests. Preqin also works with fund managers to identify institutional investors for new vehicles and carries out surveys of investors and fund managers for a variety of different clients.

Preqin has built a reputation in the alternative assets industry for providing the most comprehensive and extensive information possible.

Preqin's teams of multi-lingual analysts go to great lengths in order to ensure that products and publications are as complete as possible, both through monitoring regulatory filings, making FOIA requests, monitoring news sources, and most importantly through methodically contacting private equity professionals and investors to ask them questions and to ensure that information is accurate and up to date.

Leading alternative assets professionals from around the world rely on Preqin's services daily, and its data and statistics are regularly quoted by the financial press.

www.preqin.com **info@preqin.com**

For further information
contact the BVCA

1st Floor North, Brettenham House
Lancaster Place, London WC2E 7EN

T: 020 7420 1800
F: 020 7420 1801
E: bvca@bvca.co.uk

bvca.co.uk