



The Meaning of LP Commitments

Despite the fact that the investment industry tends to be characterized by endless self-promotional fluff, there are periodic moments of profound insight that positively enrich our collective knowledge. It is always so fulfilling when enlightenment accosts you without any prior warning. Sometimes these moments of illumination appear in the most cliché statements – phrases you can swear you have heard before unexpectedly flood your consciousness with the essence of true meaning.

While talking to a business development veteran last week about some funds he represents, the conversation meandered to the topic of LP commitments. I casually mentioned that the amount I could potentially (provided a positive due diligence outcome) invest would likely not move the needle for him because the funds' target size was quite large. He impulsively stopped me in my tracks with a serious tone and blessed me with what he described as a golden rule that has served him unfathomably well throughout his fundraising career. Verbatim, he said "I never look at LP commitments as a percentage of the target fund size, I view commitment size based on how much that amount means to the committing LP". Sound the epiphany alarms please! This simple statement is something that was mentally familiar to me, because as someone who has spent the majority of his career assessing investment opportunities for endowments and foundations, I have always been extremely sensitive to the true meaning of the value of a dollar. I have frequently heard expressions related to the significance of each dollar committed from peer LPs, but I seldom hear this degree of appreciative clarity from GPs, especially ones that have graduated from raising relatively small initial amounts.

The conversation made me think about how what commitments (particularly their size) generally mean to GPs and LPs. On the surface, commitment size is just a number that can be comparatively exalted or sneezed at, but in reality, this number carries baggage that I attempt to unpack below.

- **Natural cynics will always assume insincerity:** Veterans of the game are conditioned to view most GP statements with logical skepticism. That is simply the game we are all playing. With the large number of investment options available to LPs and the finite number of value creation methods that most GPs claim to be experts in, prospective LPs must challenge, analyze and confirm all proclamations. A GP can (and should) boldly claim that all commitment dollars, regardless of size, are important and appreciated, but it is the job of the prospective LP to authenticate such statements by carefully assessing the GP's actions.
- **The weight of a commitment:** On the surface, a commitment to a fund may seem like just a number, but behind that number are a lot of real life consequences, people, processes, decisions, reputations, and expended personal currency. Each commitment, regardless of size, is heavier than meets the eye. It is easy for LPs to simply confer the concept of "fiduciary duty" upon GPs and trust that managers will always act in the best interest of investors, but the weight of handling other people's money surpasses ordinary professional duty. In the case of foundations, educational institutions, pensions, insurance companies, etc., lives and futures can be adversely or positively affected by the outcome of investments. It is critical that GPs make it a point to understand the sources of their capital and the wide ranging implications of every dollar amplified or lost.
- **Glossing over mistakes:** Crying over spilled milk is not a recommended or worthwhile reaction to activities that have gone awry. Being overly backward looking is not necessarily a redeeming trait, but self-reflection



with the goal of doing better in the future will forever be commendable. After LPs have jumped through procedural, mental and logistical hoops to commit capital to a fund, one of the most dismissive things a GP can do is gloss over mistakes made with the capital. Of course the damage is already done, and maybe the dollars for a particular bad deal are unrecoverable (so why dwell on that?), and also maybe other transactions in the fund will make up for the bad deal - however, pretending that a floundering investment never happened is a blatant trivialization of the weight of LPs' capital. GPs who take time to assess and explain the cause of a bad deal/s to LPs are concurrently showing appreciation for committed dollars, acknowledging the privilege of being in a position to manage other people's capital, and signaling that lessons have been taken from failures.

- **Dollars still have worth regardless of vintage:** Many will know that I will never pass up a chance to hammer home this point. I believe that as long as a fund is still live and has not accomplished (in a "realized" manner) its return targets, investors, regardless of how far back they committed capital, should be treated with appreciation. I have seen too many circumstances where the most recent capital commitments in the most recent fund gets the most attention/reverence. GPs cannot forget about the source of crumbs (old and new) that came together to form the loaf they currently enjoy.
- **Purposefully strive to combat jadedness:** One of the side effects of working in the finance world for a long time is that we become desensitized to the enormity and gravity of the numbers we throw around daily. Words like "millions", "billions", and now even "trillions" lose their grandeur. I find it necessary to ground oneself from time to time. I use the average prices of homes in my neighborhood, the money my kids' schools are always trying to raise, global per capita income, my own annual earnings, etc. as ways to create perspective when I find myself getting too jaded. Although a small number of finance industry participants can personally relate to the immensity of numbers being shuttled back and forth, the majority of us have been unrealistically and unconsciously trained to be numb to the ramifications of amounts that would drastically change the circumstances of most people and entities in the world. It is important to constantly find ways to be mindful of the real weight behind these large numbers.

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