Turnover at GPs

A couple of decades ago, when I was just starting out as an analyst, I remember getting word from a GP that one of the key people at the fund was leaving. The departure did not trigger a wholesale key person event, but I vividly recall being jolted into the realization of my extreme naivete when it came to fund mechanics and real world likelihoods. I was obviously not in charge of the fund's due diligence process because of my lack of experience, but I still felt a high degree of ownership for locking up capital in an "unstable" organization for at least 10 years. That feeling of ownership was instrumental, justifiably or not, in leading to a feeling of betrayal. I could not shake the feeling that the fund was doing something very wrong. In my inexperienced mind, I thought that asking folks to lock up capital for a relatively long time was a sacred covenant that requires all related parties to stay put until promises were fully executed.

Fast forward 20+ years – I am now hardened by the realities of capitalism and carry around a healthy cynicism for anything that looks too good to be true on the surface. Impermanence is now embedded in all my thinking and analyses, and I take all beautiful stories and narratives with coarse grains of salt. I view all investment vehicles as useful instruments that have the ability to add diversification to portfolios, potentially generate outsized returns, and hold a place for the best use of capital (at the moment of capital commitment). I no longer bandy around words like "covenant" or "long term partnership" with reckless abandon. I know those words, like many others in life, can quickly and easily turn meaninglessly hollow depending on circumstance. I am not preaching a pessimist's sermon, but I do want to underscore that most of the world is guided by a selfish doctrine that dictates that self-gratification comes before the wellbeing of others – this falls in line with theories on evolution.

To be totally fair, General Partnerships (GPs) comprise of people, and life happens to people. There are many reasons why a senior member of a GP would choose to abandon ship mid voyage. Many of the reasons are valid and understandable, while others are childish and weak in justification, but turnover should never be viewed as inconceivable. All that said, I still feel a tinge of betrayal when an individual who was instrumental in marketing the positive attributes of a fund, decides to leave to pursue some new adventure that feels right to them. Below are a few thoughts about GP turnover that have helped me put things in perspective throughout the years.

- **Is it an incessant problem?:** No organization is immune from people leaving. There will inevitably be circumstances that cause some level of turnover. It is always the hope that once people get to the upper layers of management, the likelihood of them leaving diminishes. Factors such as increased remuneration, desirable incentives, impactful responsibilities, reputational risk, etc. are all mechanisms in place to reduce senior staff turnover. When a GP incessantly has senior staff turnover, there is usually something culturally or structurally wrong. Prospective LPs take senior level turnover very seriously, but a high level of junior or mid-level turnover could also be a sign of a lack of talent development - it is a well-respected badge of honor for GPs to be able to promote from within. Emerging managers, due to their relative nascence, typically don't put too much thought into potential turnover, but critical early thinking around this will help avoid (or at least prepare for) future headaches.

- **Machinery in place:** A big reason why LPs dread turnover so much is because there is a potential loss of expertise that happens when an important person leaves. When an individual has been with an organization for a long time, there is usually a good degree of idiosyncratic familiarity with the culture, methodologies and people at the firm that are painful to lose. However, because turnover is an undeniable reality, some firms strive to become a team-based or even a machine-like organization where individuals are important, but processes are positioned as durable regardless of the presence of one or a few people. This mindset usually purposely permeates through all interactions and marketing materials, almost as a means of desensitizing investors from the impact of any one individual. This is an effective approach used by GPs and I have even found myself accepting such positioning in a hook, line and sinker manner. Nevertheless, analysts must dig deeper to confirm whether a GP's processes have been so expertly institutionalized that they can autonomously be performed without the need for specific individuals.

- **Natural succession:** Some forms of turnover are necessary for longevity of an organization. Natural succession occurs when individuals at a firm have reached an organic zenith at the helm. Age, general tenure, alignment concerns, health reasons, etc. are all justifications for the need to refresh leadership. Similar to the above point, LPs need to be assured that some secret ingredient is not being lost due to the execution of a succession plan. The onus falls on the GP to telegraph succession long in advance of the actual date and make sure all questions around the quality of continuity is satisfactorily and critically answered. In my experience, the most successful transitions have felt seamless with the folks transitioning out holding some sort of emeritus or advisory role to further instill confidence that all measures have been carefully taken.

- **Were there signs?:** A knee-jerk reaction when turnover seems to have come from left field is for LPs to mine the annals of all GP interactions to determine if there were any hints. This can sometimes feel fruitless because it is after the fact. However, a real assessment of clues can help prepare an analysts to be extra wary if these signs appear during the due diligence of other managers. Snarky comments about the growth of fund/deal size, visible animosity between firm leaders, an individual expressing scorn for his/her deal being rejected for whatever reason, passive aggressive comments related to a lack of acknowledgement for work contributions, etc. are a few things I have found to be precursors to turnover. Without making manager due diligence sound like an endeavor that requires the over analysis of every spoken word, analysts must be hyper vigilant with all statements that may look, sound or smell funny.

- **Reputational damage**: I believe GPs hate turnover as much as LPs, particularly the turnover of capable people who were indisputably accretive to the organization. High turnover makes future fundraising more difficult. Just like a job candidate that is viewed as a job hopper because of multiple short stints, GP turnover brings up questions that are not fun to answer. GPs typically do not want to make it overly easy for prospective LPs to pass on their fund – high turnover tends to grease the "we'll pass" gears. High turnover puts the reputation of a GP in jeopardy. There are only so many times you can say, "all the folks who left were bad or were purposely nudged out", or "turnover is high but there is a different reason for each of them", or "the bad deals were executed by the folks no longer here", etc., before the prospective LPs starts to call BS.

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