What are GPs/Sponsors Actually Doing? – The Details Are Starting To Matter More Than Before – Part 1

The pool of private investment options grows more crowded by the day. Most LPs are inundated with pitches from eager GPs/sponsors yearning to forge new relationships and messages from current GPs/sponsors seeking to nurture existing relations to avoid future abandonment. It is my view that the continuing explosion of private investment options has led to an increased desire for LPs to find efficient methods to better discern the value-add skills of GPs/sponsors. Old wins still count, clear narratives still count, and transparency/honesty will always count, but all those aspects are beginning to count less than a clear and granular proof-based articulation of what is actually being repeatedly and introspectively done by the GP/sponsor to create value. If you listen closely to the collective chorus of the LP zeitgeist, you can make out a fairly audible shifting of tone from "I trust you because your past performance bears out all that you say you do" to "Going forward, there are a few things I will need to granularly confirm".

As I continue to build a catalog of writings primarily focused on the various facets of LP/GP dynamics, I know some of my points/thoughts are starting to veer toward "broken record" territory – for this, I apologize. My main excuse is that many topics around alignment, trust, due diligence, engagement, transparency, credibility, human nature, etc., have elements that intertwine. Regarding the topic of the deeper probing of what GPs actually do and the interrelated subject of LPs' higher selectivity hurdles, in a stream-of-consciousness manner, I will attempt below to untangle the dynamic jumbled yarn-like ball of LP sentiments.

- **Why are LP/GP conversations changing, and why is GP scrutiny increasing?**: As was mentioned in the introduction, the answers to these questions are quite straightforward. The number of investment options available to investable capital is at an all-time high. LPs are also coming to the realization that the past economic environment of cheap capital (low interest rates) likely made many investment managers look better than they actually are. Also, the wide availability of technological tools (like AI), the ubiquitous use of broadly skilled advisors, consultants, and in-house operating partners, the ease of access to placement agents and other astute guides of the industry, etc., have made the positioning of GPs as viable investment options more efficient – on paper, most look reasonably decent. Oh, also, let's not forget the recent general slowdown of distributions. All this means that LPs also have to up their game to contend with the sea of viable sameness. Easy credit is now given to no one. Well, maybe the elite managers who have kept their greed in check (through the maintenance of logical fund sizes and the avoidance of disrespectful fund terms), have navigated multiple market cycles, and have delivered tangible alpha will forever get a pass – very, very few names come to mind.

- **How are LPs increasing their scrutiny of GPs?**: Slowly going away are the days when you can just simply analyze a chart that breaks down a GP's value creation in basic "multiple expansion," "leverage reduction," "revenue growth," etc., terms and feel accomplished. LPs now want to go much deeper. To start, LPs want to clearly understand the inner workings of those "value creation bridge" charts. How are those calculations being done, and how much can we trust the data? Then, moving to the actual meat and potatoes of value creation, there is a flurry of questions that need to be answered. Although this degree of getting into the weeds can be applied to sales, pricing, operations, ERP systems, etc., let's use revenue growth (since it cuts across multiple private asset classes) as an example. How was revenue grown (organic or inorganic)? Who (internal or external) was in charge of creating the growth plan? How was the growth plan monitored? How often was the growth plan compared to projections? Who (internal or external) was

in charge of course corrections? What systems/technology was used to assess the reasons for the revenue growth? And so on and so on. This rabbit hole of logically important questions seems overwhelming, but the detail is important to nurture confidence. Also, LPs can (and are) creating processes around receiving and confirming answers to these questions, which makes each subsequent due diligence a little easier. Today, more than ever before, LPs who fully understand the value of their capital, want to also fully understand the nuts and bolts of how "value" is being created in their portfolios.

- **Proof of repeatability creates distinction**: The initial heavy lift of granularly understanding what GPs are actually repeatedly doing to add value vastly helps in manager ranking, market mapping, the assigning of manager trait labels (hands-on, outsourcers, true operators, etc.), pinpointing one's own GP preferences, informed portfolio construction with true diversification, etc. All managers will land on some part of a continuum of desirable attributes (to differing degrees). Having a clear and granular picture of what GPs are actually doing with portfolio holdings allows LPs to confidently (at least more than before because the work has been done to attain better backup data) distinguish managers with preferred/desired/desirable traits.

Looking back at this piece, I worry that the points are too backward-looking and also don't give enough credence to very important qualitative factors. To clarify, backward-looking verification is done to increase confidence that past actions will be repeated or tweaked in the future. Additionally, all work on a manager should never be performed in a vacuum; qualitative factors are always in play – I will delve deeper into this in Part 2.

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February 16th, 2025