How Can A GP Salvage An LP Relationship?

Last week, a shotgun due diligence I conducted on a fund approximately 13 years ago randomly came to mind. The manager was raising its third fund and had already hit its stated target. However, the fund had no hard cap, and five weeks remained until its scheduled final closing. Recognizing the tight timeline, which we knew would be nearly impossible to meet given our general goal of a thorough fund assessment that typically required at least eight weeks for a high degree of confidence and conviction, we still took the meeting. In all honesty, the meeting was strategically taken as a courtesy as well as a way to build rapport for the next fundraise, because the manager's ethos and its strategy seemed unarguably exciting on paper. As fate would have it, the meeting went extremely well – almost too well – so well that the primal brain sounded the loudest of self-sabotaging alarms. But we felt there was something there. The manager came across as genuine and hungry, and its differentiation did not have to be awkwardly self-promoted because it was effortlessly evident. The conversation meandered from quick surface tidbits typical of an introductory meeting to deeper dives into topics such as overarching organizational goals, investment discipline, and cultivating a thoughtful organizational culture that fostered a healthy mix of team collaboration, intellectual dissent, and data-informed risk-taking. The meeting was scheduled for an hour, but the manager was gracious enough to give us over two hours to exhaust our initial questions. Fondness for a manager can develop quickly, and an effective introductory meeting can serve as a strong catalyst for positive momentum as well as open the flood gates for various forms of bias (primarily confirmation bias). It was clear to us that this variety of initial synchronicity with a GP was extremely rare - I would venture to say that only one in about two hundred initial meetings goes this well. The magic was palpable, the enamor was mutual, but the time to get acquainted enough to hand over millions of commitment dollars was short. So what do we do?

In the classic anticlimactic fashion of an investment analyst, the spoiler was placed plainly in the first line of the first paragraph – we embarked on a shotgun due diligence exercise. We were aware of the downsides of rushing through due diligence, and we were also concerned that jumpstarting due diligence from such an extremely positive initial interaction created an implicit GP expectation of a positive outcome. We countered these fears with a strategic approach – 1) we were going to prioritize due diligence on the manager and use all needed resources to do so, 2) we were going to execute our traditional due diligence process in an expedited manner without cutting any corners, 3) we were going to be transparent with the manager and give them weekly updates on where we stood in our process 4) we were not afraid to completely walk away if too many unknowns appeared or if we felt undue pressure of any kind. The manager was very accommodating, because 1) I think the GP was made up of generally good human beings, 2) the fund was not being held open solely on our behalf, 3) it is just good business to build relations with allocators that could potentially end up paying you fees for 10+ years 4) an investment from us would bolster their endowment and foundation count which was a relatively smaller part of their investor cohort.

In summary, the due diligence was successful, resulting in a total investment of over $50 million from various endowment and foundation clients. The relationship started very well but as time wore on, some questions began to bubble up. To be fair, many of the questions or minor concerns were qualitative in nature – there were no real complaints about how the fund was being deployed or the quality of underlying deals. However, the accelerated due diligence process always lingered in the back of my mind because, regardless of the thoroughness applied, the shortened timeframe before committing capital served as a persistent reminder of potential oversights. By the third or fourth year, when the manager was preparing to raise its subsequent fund, my concerns had grown – I was not very happy with ongoing communication with the manager, and I was also uninspired by the pace of

previous fund exits. Looking back, I think I was being motivated more by emotion than critical data. Furthermore, damage control occupied my thoughts – I was worried about committing further to a manager with whom the relationship began so hastily. As the resident private assets expert, I expressed my concerns to the broader team, and my opinions held significant weight. Thankfully, a consultant (in other words, someone closer to investible capital) in our organization, whose clients had invested the lion's share of the $50+ million into the previous fund, pulled rank. He was less emotionally invested in the relationship because he wasn't as close to it as I was, allowing him to view things from a more objectively practical standpoint. The consultant and his clients were satisfied with the progress and prospects of the fund and were eager to re-up. We re-upped in the subsequent fund, and looking back, this was a great decision. Both funds generated strong outsized edible returns. This was a watershed moment for me because not only did it teach me to be less emotional around qualitative aspects of fund assessment, it also brought to light how fragile GP/LP relationships can be – the GP did not know what was happening behind the scenes, all they saw was an LP who invested in one fund and re-upped in the next.

This memory got me thinking about how GPs can proactively (or reactively) save LP relationships that are (or could soon be) on the brink of dissolution. Below are some quick points to ponder.

- **Open lines of communication**: I believe the onus of honestly and transparently airing the state of GP/LP relationships falls on both parties. GPs should proactively share investment updates as clearly as permissible/possible, and LPs should not feel inhibited to communicate expectations and grievances. GPs can also err on the side of caution by proactively scheduling periodic check-ins to gauge the sentiment of LPs and/or create recurring surveys to gather general opinions from the LP base. Open lines of communication will quickly bring issues to the surface before they reach the unsalvageable stage.

- **Admitting mistakes and being conciliatory**: GPs should be transparent about their missteps, whether in investments or communication. GPs must possess sufficient emotional intelligence to acknowledge fault when justly assigned and to seek ways to be conciliatory to LPs while addressing shortcomings. There is a significant human element in all GP/LP relationships, so addressing issues with integrity and a subdued ego creates ripple effects that extend well beyond the transactional foundation of the union. When trust is genuinely established between a GP and an LP, there is a considerable opportunity for longevity.

- **Proving increased alignment and providing incentives**: At times, a GP may be facing a situation where LP relationships need full-out Level 1 (immediate and life threatening) triaging. This typically occurs when there has been a prolonged period of weak investment outcomes, when a team member regarded as a valuable part of the organization departs, when a fund- or sector-specific news headline creates hesitation within its LP base, etc. In these circumstances, the GP must demonstrate greater alignment and/or offer incentives to assure LPs of its commitment to staying on a worthwhile course. Approaches that could work include a significantly higher GP commitment compared to industry standards, expanding the pool of team members who receive carry, full dedication to a European waterfall, management fee breaks for early, large, and loyal committers, and a thoughtful, deliberate organizational overhaul with clear proof of no coverage weak spots, among others.

- **Absolute versus relative**: As I wrote about last week in the article "As LPs, How Punitive Should We Be To GPs?", a GP can be aggressive about turning their weaker relative (versus benchmarks) track record into an argument about absolute returns. This argument can be successful if all other factors such as

transparency, integrity, likeability, trust, and sector expertise are in place, and the GP has a good reason (cycles, genuine bad luck, unexpected turnover, etc.) for the relatively weak performance.

- **Data – testimonials**: If a GP can provide data that demonstrates actions are being taken to address perceived weaknesses, LPs generally welcome such efforts and may potentially postpone a complete departure from the manager. For example, if an "operating partner" component has recently been added to the organization, real-time data on operational improvements can be provided to LPs to show the positive effects of ongoing efforts. Additionally, testimonials from portfolio company management who are directly collaborating with operating partners and witnessing the benefits firsthand can be shared with LPs to help dissuade hasty termination of the partnership.

Maintaining healthy GP/LP relationships requires proactive communication, transparency, and a willingness to acknowledge and address mistakes. GPs must demonstrate alignment with LP interests and may need to offer incentives to secure trust during challenging periods. Emphasizing absolute returns and providing concrete data on improvements can help GPs reassure LPs of their commitment to success. By fostering trust and integrity, GPs can build long-lasting partnerships with LPs. Ultimately, the strength of a GP/LP relationship lies in mutual understanding and a shared vision for the future.

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