

Private Equity Funds of Funds

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Introduction

A private equity fund of funds may be broadly defined as a portfolio of several investments in funds organized and run by private equity fund managers (described in this chapter as “General Partners” or “GPs”, and their funds as “GP funds”), who themselves invest that capital in a variety of securities usually in unlisted/private companies. This definition includes:

- Pooled funds of funds established and managed by independent specialists groups who collect, pool together and invest capital from third parties
- Proprietary funds of funds, or segregated accounts, managed by discretionary or non-discretionary managers/advisors
- Captive groups within banks and asset management organizations.

This chapter will be directed particularly toward private and institutional investors (also known as Limited Partners or “LPs”) who invest or are potentially interested in investing capital in the private equity asset class, and for whom a fund of funds is one possible option.

Why funds of funds exist

Private equity is an asset class that offers investors the opportunity to make attractive long term returns that exceed the publicly quoted markets. However, these returns do not come without effort. Private equity is specialized and heterogeneous. The differences amongst private equity firms span a number of parameters: geographic focus, investment style, size of fund, types of portfolio companies, industry sectors, and types of security invested in. There are thousands of private equity groups worldwide, encompassing a tremendous variety of strategies. Since the private equity groups are themselves rarely publicly listed entities, there is little publicly available information about their performance.

The variation in performance among the best and poorest performing private equity managers is high. According to Venture Economics, the top quartile net internal rate of return (“IRR”) for all private equity funds in Europe between 1980 and the beginning of 2005 was 23.4% and the median net IRR was 14.7%. This difference of over 8% per year compounded over 24 years is considerable. Since the dispersion in terms of performance is much higher in private equity than in listed equity or fixed income, it is imperative to deploy one’s capital with the better-performing private equity GP funds.

These GP fund managers invest in private companies in which they play a central role in facilitating the creation of value while managing varying degrees of risk. The investments are by nature illiquid until the GP completes an exit, which typically takes between two and eight years. Therefore, a single investment in a GP fund bears much more risk for the investor than an investment in a diversified fund of funds. An empirical study by T. Wiedig, A. Kemmerer, and B. Born¹ demonstrates that:

- The probability of receiving a negative return on invested capital is over 20% for a single GP fund investment. This falls to a range of 0.1% and 1.7% for a fund of funds portfolio of 20 GP funds.
- The risk as the standard deviation of IRRs is much smaller for funds of funds than for individual GP funds. For example, the standard deviation for individual venture capital funds

¹ T. Wiedig, A. Kemmerer, and B. Born ‘The Risk Profile of Private Equity Funds of Funds’, *Journal of Alternative Investments*, Spring 2005

in Europe is 27.47 compared to 5.53 for a portfolio of 20 venture capital GP funds. The difference in standard deviation is similar for buyout funds.

Because of the variety and private nature of the asset class, a specialised set of skills are needed to evaluate the risk and return potential of GP fund investments. However, many investors have the problem that private equity represents only a small proportion of their overall allocation of financial assets – usually less than 3% and not often more than 5%. These investors therefore cannot justify the cost of having a dedicated, in-house team focused on it. Therefore, funds of funds can play the role of agent for investors who cannot, or choose not to, invest themselves in the resources necessary to determine who the future performers will be (and to avoid the future underperformers).

In addition, for many entities the amount of capital available to invest in private equity is small from the standpoint of GP fund managers. The reason for this is that the process by which GPs raise capital from investors can be long and tedious. GPs therefore have strong incentives to establish long-term relationships with investors who are able to invest significant amounts of capital in the GP's current fund and potentially in successive funds. Since GP funds vary in size significantly, from approximately \$50MM at the small end to \$10B+ at the large end, what they considered to be "significant" can vary. A rough estimate may be taken from the minimum investment suggested by most Private Placement Memoranda ("PPMs", effectively the GP's main marketing document when raising a new fund); this usually ranges from \$2MM to \$20MM, with the majority being in the area of \$5MM. A well-diversified private equity portfolio of 15 investments would therefore require approximately \$75MM to be invested, and should ideally be invested over several vintage years. If the objective were to reach a 3% overall allocation in the LP's portfolio, this means that only investors with at least \$2.5B of capital under management are able to build their own program. However, even making these 15 investments may be more difficult than it would appear. For the reason indicated above, many GPs may not wish to have a one-time investor in their fund that may not have additional capital to invest in their subsequent funds. This may limit the LP's choice of GPs in which to invest, and undermine its ability to deploy the desired capital optimally.

Funds of funds address all of the above issues. As dedicated participants in the private equity market, they also collect a tremendous amount of information on macroeconomic and sector trends, and on the broad variety of GPs' approaches to opportunities in the market. A good fund of fund manager can use this information to triangulate data originating from differing sources and perspectives to separate real opportunities from good salesmanship on the part of the GPs. Virtually every GP claims that their fund is top quartile, and is able to give a reasonable justification of it. Funds of funds also have relationships with GPs that have been built over time, or by reputation. These are often important in providing access to GPs whose funds have performed so well in the past that they can effectively select their investors, and are always oversubscribed. A proactive fund of funds manager is also on the lookout for new teams that show exceptional promise on the basis of their experience, motivation and differentiated strategy – and only by continuously meeting many teams is it possible to distinguish what teams are truly "exceptional" in this regard.

Funds of funds may also be useful for investors to get specific exposure to niches of the private equity market which do not form a core part of the investor's program, are relatively difficult for an investor to access, or are particularly specialized. Examples of such niches are as follows:

- o Different geographies, for example an Asian fund of funds for investors whose current portfolios have little exposure to Asia

- Different types of private equity funds, e.g. a venture capital fund of funds for investors who wish to have some exposure to venture capital, but would find it difficult to establish a diversified portfolio of investments without going the fund of funds route
- Variations on the above two, such as a fund-of-fund focused on mid-market buyouts in Europe for US investors. A number of these investors have some exposure to large pan-European buyout funds but have little or no allocation to the vibrant lower end of the European mid-market because of geographic remoteness and higher language and cultural barriers to access funds operating in more local markets.

In this way, a tailored fund of funds investment can complement an existing portfolio of GP funds and/or direct or co-investments.

In brief, there are a number of strong reasons why private equity funds of funds exist and can play a useful role in helping many LPs get exposure to this asset class.

Investing in a fund of fund versus in GP funds

A familiar commercial analogy to contrast the ways in which one can invest in private equity is the “make or buy” decision.

“Buy”. Choosing to invest in a fund of funds is comparable to outsourcing the manufacturing of a product, or the full provision of a service, to an arm’s length third party. The third-party supplier may provide a product or service from its existing suite of offerings (a pooled fund of funds), or may customize an offering to suit the client’s needs (a proprietary fund of funds, or segregated account). There are a number of advantages to this approach:

- A fund of funds will have an existing, experienced team which is already fully mobilized, is benchmarking active funds in the market against each other, and is making investments. Also, funds of funds are more able than many investors to attract and compensate specialized, high quality private equity investment professionals. A fund of funds can offer a career path from junior to senior roles at competitive remuneration, plus the future prospect of sharing the profits of the business (carried interest). Many investors are not able to match this.
- It is easier to achieve diversification in two ways: first, by outsourcing the selection process to a private equity investment specialist who has economies of scope; and second, by piggy-backing on the fund of fund manager’s scale, a small amount of capital can get the same diversification as larger commitments of capital.
- It distills the investor’s approval process down to one decision, instead of having to make multiple decisions at the GP level.
- A quality fund of funds will have a good reputation and established relationships with well-regarded GPs, making them attractive investors to the GPs. This is a particular advantage when trying to get access to funds that have a strong past track record, can often be oversubscribed, and can therefore be selective in admitting new investors.
- It reduces the overall administrative burden for the investor, since negotiating the terms of each investment, maintaining communications with the GPs, monitoring the progress of investments, and dealing with issues that arise are all undertaken by the fund of fund manager.

There are a few disadvantages to this outsourcing approach, however:

- The main one is the additional layer of fees that must be paid for the above services. For a pooled fund of funds, it would typically consist of an annual fixed fee of 50 to 150 basis points on the amount of capital committed, plus usually a share of the profits (carried interest) of 5% to 10% after the investor has had its original capital and costs returned, often linked to a preferred return of between 5% and 8%.

- Choosing a mediocre fund of funds is likely to result in the investor achieving no better than average private equity returns, which are at best comparable to public market returns.
- Compared to making GP fund investments, the investor is not as directly involved with the investing activity, and therefore has less opportunity to build its own base of direct knowledge that would improve its future ability to invest in the asset class.

“Make (With Partners)”. Choosing to invest directly in GP funds is akin to deciding to undertake manufacturing in-house, or having an in-house department provide a service, but where outside suppliers (the GPs) provide components or service elements to support the effort. This of course requires that the investor have appropriate in-house resources in order to execute this strategy. The advantages for the investor are that:

- It acquires its own proprietary expertise in private equity investing
- It is able to fully control the investment strategy at the GP level, and to choose exactly which GP funds to invest in, in accordance with the investor’s particular needs
- GP funds report directly to the investor, who can establish and build long term relationships in the private equity market
- A successful strategy may, over time, allow the investor to establish its own fund of funds business where it offers fund of funds investment opportunities to other investors

However, undertaking this task in-house is an initiative that requires management time and effort, and a serious long term commitment of resources. The associated disadvantages are:

- The need to build sufficient scale to make the initiative worthwhile. Building an in-house team can be very expensive, and therefore it is necessary to establish that the long term program of private equity investment warrants the investment being made.
- The difficulty of identifying, attracting and incentivizing top private equity investment professionals to join a captive, in-house team versus working for an independent specialist.
- If the commitment to private equity weakens at some point, the portfolio may never achieve a healthy level of diversification, leaving a half-baked effort that exposes the investor to excessive risk.
- It takes time to build the relationships and credibility that gives one organization preferential treatment to another. GPs have seen varying degrees of commitment by investors to private equity, and have a preference for steady, long term investors.

“Pure Make”. Choosing to make direct investments in companies, through either a direct strategy or a co-investment strategy, is like having the whole manufacturing process or service function kept in-house. This in fact is the most flexible way to invest in the sector and attracts no fees from intermediary players. However, the fixed costs of this option are very high, and worldwide only a small number of typically large, highly sophisticated investors make significant numbers of direct investments.

Many investors are put off by the extra layer of fees charged by funds of funds, which are on top of the fees that will have been charged by the GP funds in the underlying portfolio. If the fund of fund’s performance is no better than the average performance across the private equity market, then this concern is wholly justified. However, since the top GP funds significantly outperform the market average, the overall value that a high quality fund of funds manager brings to its investors in terms of returns and the associated services that come with them, easily exceeds the cost of the extra layer of fees. For this reason, it is so important that an investor conduct a thorough review of the funds of fund managers before choosing a manager. Below is an outline of the main fund of funds structures and useful tips to selecting a fund of fund manager.

Different types of funds of funds

There are two main structures for funds of funds.

Pooled Fund of Funds. This is a structure established by an organization that is specialized in investing in private equity funds. It typically consists of a standard limited partnership into which investors pool their capital. All investors in this limited partnership structure invest in the same set of GP interests from this pool of capital, in proportion to their commitments.

Advantages:

- There is a broad selection of funds of funds available for investors to choose from at any one time. It includes funds of funds that provide broad exposure across private equity, and specialized sector, style, stage, or geographically focused funds of funds.
- An investor can get exposure to private equity with only a very small commitment (e.g. a few million dollars) to start with.

Disadvantages:

- The strategy can't usually be changed during the investment period, because it was the basis upon which the fund of funds convinced investors to commit capital. The investment strategy can therefore be inflexible, and unable to adapt to adverse changes in the investment environment.
- Once the choice to invest in specific fund of fund has been made all investors in the LP structure invest in the same assets, and small to mid-sized investors have limited influence over how the fund of funds directs its investment strategy. For example:
 - A fund of funds that deploys capital too quickly risks being overexposed to a specific vintage year. Private equity returns can vary significantly by vintage year.
 - A fund of funds that invests in too many GP funds risks diluting its overall return. A good fund of funds should not make average private equity returns – which are no better than the returns from the public market – but rather exceptional returns from investment in a selection of only the best prospective performers.

Proprietary Fund of Funds / Segregated Account. This is a structure established jointly by the fund of funds manager and the investor, to meet the latter's legal, tax, strategic and other specific needs.

Advantages:

- The investor can have significant influence over the amount of control of the investment strategy and execution that it wishes to have.
- The strategy can be adjusted during the investment period. Such adjustments may be needed in response to changes in the investment environment, such as macroeconomic shocks or increasing competition in the original areas of focus. In addition, adjustments may be useful to address changing investors' needs, such as the shifting of focus in the remainder of their asset mix, or to refine their cash deployment.
- Depending on the investor's needs and interests, the communication can involve a deep transfer of knowledge on private equity investing to the investor.

Disadvantages:

- It requires some additional effort on the part of the investor to identify the fund of funds manager to work with and to determine the optimal investment structure.

- The investor needs to make a minimum commitment (in the order of at \$30MM to \$50MM over several years – varying by fund of fund manager) so that establishing and managing a customized offering is worthwhile both for the investor and for the fund of funds manager.

How to choose a fund of funds manager

Fund of funds managers enjoy a significant asymmetrical information advantage over most investors, particularly over new investors to the asset class. This can make it difficult for an investor to differentiate between them, to understand the relative significance of the benefits each offer, and to choose the ideal fund of fund manager or advisor. This short guide is aimed to help redress this imbalance. It discusses factors that are important to consider, and provides some practical advice as to how to effectively make evaluations. Although the first few factors are often cited – team, track record, and investment strategy – and are indeed important, there are a few additional points less often mentioned that should help a potential investor to take their evaluations a level deeper.

Team / Organization / Motivation. Clearly the overall quality of the firm’s management and investment team is critical. Relevant and extensive past investment experience is a must. Aside from this, there is a range of past expertise and experience that can add value to the team, so there is no set formula to evaluating it. It is important to assess the range and depth of the intellectual rigour that the team is able to bring to bear to its decision-making. It is equally important to get a sense for how well oriented and motivated all of the individuals in the organization are to generating the best results for clients/investors. A few questions to ask are:

- Are the same professionals who were responsible for the firm’s successful track record still as engaged and motivated to repeat that success going forward?
- How are rewards shared across the team; does everyone have a good incentive to perform?
- What mistakes has the fund of funds made in the past, and how have they learned from them? Regardless of whether they consider them “mistakes” or not, ask them to discuss their poorest performing GP investments to date, and particularly any recent ones. Despite the poor results in these cases, had the fund of funds conducted rigorous due diligence, followed their own disciplined internal process, and executed on their purported investment strategy?
- Who are the owners of the firm, and what are their aims in building their business going forward? Does their answer indicate that they are truly aligned with their investors, or are they more interested in just building a larger business (remember, more capital under management equals more fees)?
- How hands-on are the most experienced members of the team in investment analysis and investment decisions?
- If the firm has had considerable past success and its principals are already well-off, how hungry are they to maintain their success, and how oriented are they to the ongoing needs of their clients/investors (rather than coasting on past success)? For example, is the magnitude of capital that they commit to their funds alongside investors significant to them personally?

Track Record / Performance. As a result of the number of years it takes private equity firms to make and then exit investments, it takes much more time to clearly demonstrate performance in this asset class than in most others. A prospective investor should review the fund of fund’s most recent performance reports, covering all of its past investments, and ask:

- How has the track record been calculated? Does it include all relevant investments the firm has made, and if not what has been excluded?
- What does the current unrealized part of the investment portfolio look like? Remember, the great majority of the “proven part” of a fund of fund’s track record is already at least 3 or 4 years old, since capital is typically deployed over a 4-year investment period and then requires

time for exits to generate returns. Therefore, the “proven track record” is usually already old news.

Investment Strategy. Since the variance between the best and poorest performing GPs is so great, choosing the GPs that will in the future outperform their peers is a central objective of a fund of funds manager. Therefore, it is important to understand how the fund of fund manager intends to achieve this. Is the firm a thought leader or a follower? As with any other investment, past performance is not necessarily a good indicator of future performance. The private equity market is just that – a market, or more precisely a set of niche markets – which are driven by the same supply and demand dynamics as any other market. The danger of being a follower in any market is chasing momentum. This was illustrated on a grand scale during the dot.com boom: many early investments did well, but most everyone else who followed behind suffered after excess supply of capital drove prices to unsustainable heights. While this is a somewhat extreme example, capital mobility into and out of niches in the private equity market has a strong effect on GPs’ abilities to outperform. As a result, a potential investor should ask a fund of funds manager the following questions:

- What is their investment philosophy and how does it lead to exceptional performance? How rigorous are they in their thinking? What kind of research do they undertake to support their investment theses?
- How proactive is the firm, and what work does it do to stay ahead of the curve?
- Where in the private equity market do they see the best risk-adjusted returns to come from in the next 1-2 years? Does their response demonstrate a proactive approach to finding opportunities, or a complacent backward-looking approach?
- It is all well and good to spend time analyzing the well-known funds, but how does the firm identify emerging managers - the “hidden jewels” from the several thousand GPs operating worldwide? How have the emerging GPs they have invested in performed to date? If they don’t invest in them, it is necessary to make a judgment as to whether the firm’s investment strategy is more forward-looking or backward-looking.
- Ask the firm to give examples of where it took a lead in committing to a GP, and then call the GP to ask about the fund of fund manager’s investment approach.

A potential investor could also call one or more placement agents (whose role is to help GPs raise capital from institutional and other investors) to ask which fund of funds they consider to be the most rigorous, proactive and forward-looking, to avoid investing in a fund of funds that is just coasting on its past success.

Investment Execution. A sound private equity investment strategy needs to be backed up by solid processes that impose a consistent level of intellectual rigour, discipline, and effort from the early research and identification stages through to investment. An investor should ask the firm to demonstrate:

- How many GPs it is in contact with, and how it tracks them.
- What analysis it undertakes at various stages of assessment.
- The scope and depth of its due diligence processes.
- The number and types of references it takes before making an investment.
- The involvement of the most experienced members of the firm in the details of the investment process.

Fees. The fact that a fund of funds will add a layer of fees on top of the GP funds’ fees is certainly an issue with many investors considering funds of funds. In principle, the advantages of a fund of fund should justify its fees. However, it is also useful to consider how fees are broken down between the annual management fee, which typically ranges between 50 and 150

basis points, and the performance fee, which is typically a percentage of profit (called “carried interest”) earned after whatever preferred return is first provided to the investor.

- Does the revenue stream that the fund of funds manager earns from the fees from all of the funds it manages just cover the firm’s reasonable operating costs, or does this fee stream already provide rich compensation for its partners? This again is an indication of where the motivations of the fund of funds’ principals lie.

Loyalty to Investors versus GPs. The focus of fund of fund managers on “access to top-quartile GPs” as their key selling point to investors has merit, but there is a risk that this emphasis shifts the fund of funds manager’s loyalties from investors to GPs. If obtaining a good allocation from perceived top-ranking GP fund ‘X’ is overly important to a fund of funds, then necessarily it needs to maintain a good, long term relationship with X in order to preserve that access. This is not itself a bad thing. However when it comes time to negotiate terms for the next fund, to review valuation policy for the investment portfolio, or to provide feedback to the GP on an issue, there is more incentive for the fund of funds manager to acquiesce on these issues to the GP, since playing too strong a hand in the investors’ interests may strain the relationship. Since these are the very GP funds that tend to be oversubscribed, and the process of allocating the investment capital of the GP’s next fund to existing and new investors is totally within the GP’s own discretion, why not then give larger allocations to the investors that have been most cooperative? Investors should ask a fund of funds manager about their policy on “re-ups” (investing in a GP’s subsequent fund to one the fund of fund had previously invested in). Also, the firm should be asked to provide a complete record of past decisions to re-up or not, and the justification for the decision made in each case.

Resolving Allocation Conflicts. A fund of funds that operates only one fund for all of its clients is likely to have a simple task in allocating investment in proportion to the respective commitments of these clients. However, where the firm operates several funds and/or separate accounts for clients, there may be instances where the firm must divide a limited allocation to a GP among them.

- It is therefore useful to understand what exposure the investor will get to the kinds of GP funds that are of interest, within the context of the vehicle being proposed and the entirety of the fund of funds firm’s obligations.

Client Service. As with any service, big or important investors/clients may be given more attention and higher priority than smaller clients. Therefore, an investor should ask up-front for the firm’s list of clients/investors, and get clear answers on what standard and ad hoc services will be provided. For example, it is commonly thought that a fund of funds is a good first step for new investors in the asset class to learn about how private equity works, before thinking about establishing its own private equity investment program. Some investors have then been disappointed when they find that the chosen fund of funds does little to actually transfer knowledge, and that after several years of investment the investor knows little more about the asset class than it did before. The specific data, knowledge, and time commitment being provided by the fund of fund manager needs to be clarified, and also needs to be credible when considering the resources the firm has available for all of its investors/clients. Prospective investors should:

- Ask the firm for a complete list of clients/investors, and should take references with a variety of these to verify the level of service and attention the firm provides to its clients.

Monitoring. A GP fund will typically provide quarterly and annual reports to its investors. These are the basic source of information regarding the progress of a private equity investment. However, a proactive fund of funds will maintain an ongoing dialogue with its GPs.

Sophisticated investors can provide helpful feedback regarding strategy, capital flows, and competition in the market to its GPs, since following the market is a central activity of a specialist investor in private equity. Furthermore, in informal discussions GPs often provide best-guess indications of future likely capital calls and drawdowns, which assist in planning future cash flow management. Overall, a fund of funds that has a strong ongoing dialogue with its GPs reinforces its commitment to the success of the GP's fund and therefore its relationship with the GP in a professional manner – giving the fund of fund a better position to take up a favourable allocation in the GP's next fund, if it so chooses. Finally, GPs will almost always organize Advisory Committees for each of its funds, which consist of a handful of selected investors in that fund. While it is not possible to have a place on the Advisory Committee for every GP fund invested in, this is another opportunity for a fund of fund to influence its GPs and further develop the relationship. Since GPs like to have well-informed, sophisticated investors on their Advisory Committee (although in many cases the de facto rule is that it consists of the largest investors in that fund), whether a fund of funds sits on any Advisory Committees is indicative of the esteem with which they are held in the GP community.

- A prospective investor should ask a fund of fund how proactive it is in communicating with its GPs, and what its policy is in terms of sitting on Advisory Committees.

Reporting. Just as GPs report to their investors, funds of funds should equally provide clear, detailed, relevant, and timely reports to its investors.

- A prospective investor should ask a fund of funds to provide examples of the types of reports that it currently provides to its investors.

Future directions for funds of funds

The fund of funds industry experienced its major growth phase during the 1990s, riding on the coattails of the great expansion of the private equity market itself. In the USA, there were 20 fund of fund managers in 1991, and 65 by 2001. In Europe, there were 11 managers in 1995, and 47 by 2001. As of the beginning of 2005, 131 funds manage \$161 billion of discretionary assets. 48% of these funds are independent specialists, 34% are assets managers, and 18% are banks. The majority of funds, 61%, are headquartered in the USA, and 36% are headquartered in Europe.²

The funds of funds that established themselves early and maintained respectable track records are now the large brand names in the industry. Over time, they have tended to raise increasingly larger funds, and multiple funds focused on different geographies or parts of the market. The large general funds of funds have also started to offer more options to allow investors to choose how they wish to deploy capital in specific sub-strategies. The other, smaller funds of funds include niche players with specific strategies as their main offering to investors. With the main barrier to entry to this market being the challenge of raising capital to invest, small players will continue to enter.

However, as we have noted above, it takes many years for the feedback loop of returns on investments to close. There are undoubtedly funds of funds with mediocre track records that continue to operate, but which will eventually struggle to raise further capital as their returns

² Almeida Capital, 'A Review of Private Equity Funds of Funds', April 2005

slowly come to light. This could even include long standing players that have established strong brand names for themselves. Because of their momentum, most of these large players can be expected to continue to be seen as the safe option for private equity investing, much like how for several decades a computer systems manager “would not be fired for buying an IBM computer”. However, this perception outlasted the actual superiority of IBM’s products and services. While small funds may struggle to establish a credible track record with investors, some of the large, successful, and profitable funds of funds may struggle to maintain their hunger, motivation and discipline over time. With comfortable fixed fee revenues it could take a number of years before investors become aware that these players are no longer in fact top performers on a risk/return basis. Just like at the GP level, some of the future top performing funds of funds will come from the ranks of current lesser known players.

In the meantime the dedicated, professional approach that funds of funds take to investing has had broad positive impacts on the private equity market as a whole. GP funds are generally conscientious about providing information during due diligence, establishing reasonable terms for investors, and reporting on the progress of their investment portfolios. However, having relatively more sophisticated investors tends to raise the bar in these areas. Funds of funds review large numbers of GP funds every year and demand high quality information and corporate governance from them throughout the investment cycle. They can be expected to monitor performance closely, and to be active and informed participants in issues that arise, such as conflicts of interests or appropriate valuations for portfolio assets. For first-time GPs or small or regional GPs in particular, funds of funds can assist in imparting industry best practices, and in this way can help to professionalize the industry. Since funds of funds need to be very selective, in the broadest sense they also play a positive role in allocating capital to strong GPs who do perform well, and not to weak ones, which in turn positively reinforces the entire private equity industry.

Conclusion

Private equity funds of funds are an excellent option for investors that want to obtain or increase exposure to the asset class but can only allocate small amounts of capital to it, or don’t wish to build dedicated, in-house resources to achieve this. It is an equally viable means for investors to gain exposure to niche areas of private equity without having to deploy large amounts of capital. A fund of funds manager that performs satisfactorily easily justifies the extra layer of fees that an investor incurs, by the added value of specialized selection and due diligence, and by greatly diversifying the investor’s risk.

Capvent AG is a specialized private equity advisory, management and services group focused on helping its clients and partners to maximise investment performance. The firm’s focus is primarily to provide low-risk, diversified, high quality access to international private equity. Its investment expertise covers the full range of investment styles, sizes and industry sectors - venture capital, buyout, mezzanine, secondaries, and special situations. Its professionals are experienced in private equity and direct investing, and the firm is regarded as being one of the most strategically forward-thinking and most disciplined and rigorous in evaluating opportunities.

The firm serves the needs of highly sophisticated and demanding private equity investors. Its international investment services have the goal of identifying the best macro investment opportunities worldwide, and matching those with the private equity groups that are best positioned to capitalize on them.

Capvent also offers specialized opportunities to investors that value a highly skilled and focused group addressing a specific situation. The group has established a significant presence in Asia to take advantage of opportunities in the world’s fastest growing emerging markets.

For more information, please visit www.capvent.com.