

Private Equity LP Co-Investments Rise, But Is The Strategy Working?



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Do LPs see better returns when they give full control to private equity GPs? A recent study by researchers from Harvard, MIT and State Street implies that the answer is, on the whole, yes.

Josh Lerner (Harvard), Antoinette Schoar (MIT), Jason Mao (State Street Global Exchange) and Nan Zhang (State Street Global Exchange) crunched the results of 40 years of State Street's custodial data across 108 private equity LPs. They wanted to understand the performance of GP-directed vehicles against "discretionary" vehicles where LPs preserved some decision-making power.

So-called discretionary vehicles have been growing in popularity, especially among the larger buyout funds. Looking across the LPs in the study, in the 1980s only 7% of capital commitments went to vehicles outside of a GP's main fund. by the 2010s, that had risen to 24%. However, only 11% was for fully-discretionary LP co-investment vehicles, and the remaining 13% was for vehicles that were still largely GP-led, but had special terms. The scholars also found that LPs based outside of North America were more likely to use these vehicles, compared to their North American counterparts.

To cut to the chase, after examining the results across several methods, the scholars concluded that "the relative performance of discretionary vehicles is significantly lower than the GP-directed vehicles."

Author Josh Lerner told *Institutional Investor*, "You're paying lower fees and carry on these alternative vehicles, so you'd think you would be ahead of the game. The average investor doesn't get much of a free lunch in terms of added returns."

However, the data also showed that the LPs who were best at picking GPs also had the top performing co-investments. In their case, the performance of co-investment vehicles actually outperformed the main PE funds.

Lerner also told the publication *top1000funds*, "If you take the conclusions of this paper seriously, then doubling down on choosing the right funds to invest in is the winning strategy for investing in private equity, rather than investing in alternative vehicles" while also acknowledging that "Those that do it well show it's worth doing... not all LPs are created equal."