



Long or short, Andreas Schmidt?

The Global Head of Primary Private Equity discusses opportunities and risks in co-investments

Do co-investors have to take a purely passive role?

SHORT The purest form of co-investment is often seen as being practiced by institutional investors such as medium-sized pension funds and insurance companies. These may have the institutional patience and implicit confidence in their counterparties to limit themselves to a purely passive role behind a lead investor. By contrast, many family offices take a more active approach while co-investing, for example including participation in corporate governance. This may not be a completely pure form of co-investment but this large and diverse constituency is important and should not be ignored.

As co-investments are generally offered on a no-fee basis, can they exhibit adverse selection?

LONG One concern may be that lead investors will offer only the less attractive investment opportunities to prospective co-investors (so-called adverse selection). One way to mitigate this risk would be to co-invest through a private-equity platform that itself produces a significant flow of investment and demonstrably pursues a highly selective approach with due consideration of its own fiduciary responsibilities.

Do mid-market funds also offer opportunities?

LONG Mid-market funds may lack the manpower and skills of the mega funds. However they are probably most in need of co-investment and their often under-resourced investor-relations teams may therefore be very keen to maintain close relations with their most active limited partners. The large numbers of these funds, combined with their relative lack of resources and organization, have meant that they have proved a fertile hunting ground for the most sophisticated co-investors.

Must fundless sponsors always be ignored?

SHORT Fundless sponsors intend to put little or no equity into the deal into which you are being asked to invest, instead taking a fee or other forms of compensation. Such deals are not for the faint-hearted, but with appropriately aligned interests there is in theory nothing to prevent a deal from a fundless sponsor outperforming one done with a brand-name fund. This may be a space to watch if investors become increasingly crowded out of more traditional co-investments.

Can use of a co-investment fund make sense?

LONG Ironically, when a private-equity platform sells a co-investment fund, it is in fact selling you a blind-pool limited partnership (one without any visibility on ultimate investments) – pretty much the exact opposite of a normal co-investment. But this can make sense for an investor. In addition to mitigation of adverse selection, with one commitment it may be possible to achieve a degree of diversification (in terms of geography, industry, manager, size, investment style and risk profile) that would be impossible to achieve with a commitment to a single manager.

LONG represents a positive answer

SHORT represents a negative answer

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