RISING TO THE OCCASION
THE LP TO GP DYNAMIC

There has been a notable change in the relationship dynamic between GPs and LPs within private credit over the last 12 months. With LPs requiring ever-increasing amounts of portfolio information, Paolo Malaguti, Founder of Credit-Vision, believes GPs now more than ever need to clearly articulate their unique selling points and leverage data to do so effectively.

For a relatively new asset class, private debt has led a charmed life for more than a decade. In the years since the 2008 global financial crisis, the sector has benefitted from banking sector retrenchment and unabashed investor admiration, by virtue of delivering a consistently strong cash yield in a sustained low interest rate environment.

But after a decade of robust growth, the pandemic of 2020 has presented the sector with its first real test. As fundraising has slowed and competition in the market has intensified, portfolio managers are finding themselves under greater pressure to perform and LPs are demanding greater information and accountability from their GPs.

This is the moment where GPs need to prove their mettle and show their value to LPs, according to Paolo Malaguti, Founder of Credit-Vision, the software-as-a-service platform for banks and investment funds. As Malaguti explains: “We are at a really interesting stage in the lifecycle of private credit as an asset class. Before Covid, managers didn’t need to differentiate themselves as much as they have to today. They knew there was money available from LPs to invest in the asset class and their strategies. But now, we are seeing a clear divergence between winners and losers, with LPs much less tolerant of average performance. That mindset imposes a new approach, and private credit managers are asking themselves some pretty hard questions – and the best managers do so before the LP starts asking them.”

WHAT DO LPS WANT?

As the private credit market has matured, transparency has become a focal point for investors and now Covid has turned this into a deal-breaker for LPs. As Malaguti notes: “The challenge for GPs right now is that LPs feel potentially much more exposed to credit risk than they ever did before. LPs are fundamentally drawn to private credit because they want to allocate capital in a way that provides them with stability and reassurance. So, the last thing they want is to be blindsided.”

Malaguti continues, “LPs now expect greater insight into what’s happening within portfolios, and at a granular level. The ‘helicopter’ view that they were happy to receive once a quarter is no longer enough. The moment that an investment is not performing against its benchmark, they want to have at their disposal the information and toolkit to understand why.”

DEMANDS FROM LPS HAVE CHANGED

Now that the relationship dynamic has shifted, Malaguti sees GPs giving LPs more of an insight into their world, communicating with them more closely and, in general, striving to enhance investor engagement. For some GPs, the transition is not easy and that is exacerbated by the fact that the technology underpinning the sector has struggled to keep up with investors’ expectations.

Malaguti explains: “Over the past decade, we’ve seen the growth of an entire ecosystem of service providers such as accountants, lawyers, founders and administrators. But the underlying technology that enables managers to look through and control their portfolio? It really hasn’t moved on. GPs are still extremely reliant on human connections and legacy infrastructure which is often more than 10 years old. But across so many other industries, this way of working now feels obsolete. LPs expect a more systematic way to navigate through managers’ portfolios and understand what is driving performance. They want to see their GP looking ahead, not just focussed on explaining last quarter’s results.”

THE POWER OF DATA

It has been 15 years since the phrase “data is the new oil” was coined by Clive Humby, but according to Malaguti, the comparison is still valid. “We live in a world of data overload, and GPs may already feel burdened with all the information they gather from their portfolio companies. But the single biggest challenge they have not yet got to grips with is how best to refine that data. They need to use it to drive their investment strategy, and to articulate their competitive edge in ways that give LPs the comfort they need.”

This determination to help managers use data to deliver unique and independent insights is the driving force behind Credit-Vision. By automating the process of extracting financial data from multiple sources into a single access point, it allows both portfolio managers and investors to make decisions based on an enhanced data-driven view of credit risk and quality. This also gives managers the information refinement they need to articulate investment narratives that are coherent and compelling for investors.

THE ADVANTAGES FOR GPS

Making a firm commitment to technology that interprets investment performance doesn’t just satisfy the demands of sophisticated LPs, it also gives GPs the opportunity to implement vastly improved systems and risk management controls.

As Malaguti explains: "The ability to run portfolio simulations, and hypothetical 'what if' scenarios that calculate optimal portfolio allocation, is more important now than it has ever been. GPs need to be able to make robust and reliable performance forecasts that clearly set out where they expect portfolio companies are going to be next quarter, or in the next year."

"Another example of technology adoption benefiting the GP to LP relationship is covenant monitoring. Increased earnings volatility has intensified the pressure on covenant compliance. So, for the portfolio manager, it is critical to be able to look across the entire portfolio and, at the blink of an eye, say where every company stands with their covenants, and ideally where it is set to be over the next testing dates."

CAN GPS ADAPT TO INCREASING DEMANDS FROM LPS?

After a decade of runaway success, a period of stable growth and fund manager differentiation is a welcome sign of market maturity. But the transition will be easier for those GPs that recognise the need to improve on technology adoption and partner with providers offering the toolkit and know-how needed in today's market environment. As Malaguti confirms: "Looking ahead, I think the next three years are very positive for firms like Credit-Vision, purely because there is such a necessity within the private credit space for the solutions we provide. The merger of IHS Markit with S&P Global Inc last year, which was the single largest M&A deal of 2020, really speaks to data and technology emerging as an integral part of investment managers' decision-making processes and investment strategies."

Malaguti concludes: "Right now, GPs face two pressing issues. First, they must be able to prove that portfolio performance can – and will continue to – deliver on what they promised. Second, they need to articulate their unique selling points and convince LPs of their superior insights and clear vision for the future. Those that can continue to do both are very well placed." *

Contact:
Paolo Malaguti
Founder & CEO of Credit-Vision
+44 (0)20 3668 3675
Paolo.Malaguti@Credit-Vision.com