

EU membership

Five things non-Europeans need to know about fundraising in Europe.

By Jennifer Harris

Europe, as a fundraising destination for US and other non-European general partners, used to be something of an afterthought. Bruce Chapman, director of the London office of global placement agent CP Eaton, says of the Eurozone fundraising trail: “It was somewhere that you went once you saw that you had quite a significant portion of the target capital raised, and you saw yourself picking up a few but not many new European accounts on the basis of a relatively quick sweep through.”

This is no longer the case, as more and more GPs visit the Eurozone in search of highly prized LP commitments. Chapman notes that now managers in the US and other regions are realizing that there is more appetite than ever in Europe. At the same time, the sophistication of the European LP base is on the rise, and investors there are more receptive to complex, niche products. GPs can’t afford to overlook Europe anymore.

But before you take your roadshow on a European adventure, there are five things you need to know, according to local fundraising professionals who have witnessed their share of culture clashes and regulatory missteps in meetings.

1. Relationships matter

“Europeans are very relationship-driven,” says Charles Lemon, a partner at London-based placement agent Matrix Private Funds Group. This is true for all fund sizes, but acutely so for GPs in the lower middle market, Matrix’s primary clientele. European LPs need time to get to know a fund and its managers before they feel comfortable backing it. These relationships can take years to build.

“Europeans are unlikely to back a non-European fund the first time they see it,” Lemon says. “They like to spend some time getting to know the fund, getting to know the portfolio, getting to know the behavior of that part of the world.”

It’s best to approach a European LP at least a year before a fund goes to market, maybe even two, he says. This gives the LP time to keep an eye on your activities, to watch your team execute deals and manage portfolio companies. Don’t rush, and expect the whole process to take a little longer than you hoped, because European LPs tend not to chase returns as aggressively as, say, their US counterparts. Putting time pressure on them to commit before they’re comfortable won’t get you anywhere.

“European LPs are happy to say no,” Lemon says. “If they miss a fund, they miss a fund. There are a lot of investment opportuni-

ties in the market and no one loses money by missing a fund. Putting time pressure on an LP is more likely to push them away than speed up the process.”

2. Mind your language and manners

It’s crucial to keep in mind that English is not necessarily the first language of every European LP. Everyone in the meeting might be speaking in English, but failing to communicate nonetheless.

“The word usage is completely different, so there’s a very high tendency to talk across one another,” says Mounir Guen, chief executive of London-based placement agent MVision. “When question is misunderstood, there’s a tendency for the non-European partners to talk into the space. So they’re talking all the time, and not actually listening and trying to figure out what’s being asked of them.”

Non-European LPs also often show a deaf ear to certain cultural nuances, Guen says. For example, certain European cultures are less garrulous than, for example, American culture. Many American GPs like to be questioned, and if they are not they might consider the meeting unproductive even though the investor was in fact interested.

Non-European firms, particularly US firms, also tend to send their top people to every meeting, whereas a European LP might send out someone more mid-level to meet them. GPs shouldn’t interpret this as a sign that they aren’t being taken seriously, says Lemon.

“I think sometimes GPs tend to be over-enthused by the requirement to see the head guy,” he says. “Where in reality, the guy who’s going to be doing the work is the investment director or the investment manager. That’s who’s going to be writing the report and doing a lot of the due diligence, and some of these guys are quite young.”

US GPs are uniquely susceptible to two other common pitfalls, Guen says. They often act too casual and relaxed during the meeting, for one. “Try to maintain a professional tone during the whole meeting,” Guen says. “It’s nice to be pleasant; you don’t need to be friendly.”

Second, US GPs can lack certain subtleties in decorum that Europeans appreciate. GPs who fly in on private planes and ride around in luxury cars might seem a bit gauche to a European who was brought up to appreciate discretion.

“There’s an appreciation of success,” says Guen, “But there’s a sensitivity to flashiness.”

3. Details, details

Whereas a US LP might expect the first meeting to be more conversational, European LPs often expect to glean substantive information from the encounter, based on which they will decide whether or not to move forward with the manager.

“The LPs in the US market will take meetings to learn about the market, but the Europeans only take meetings if they’re interested,” Guen says. “There’s a huge amount riding on that meeting, and people don’t understand that.”

A GP needs to be prepared not only to answer questions about their team and track record and provide anecdotes and case studies, but also to describe in detail the sectors in which they operate.

“European investors generally are extremely detail-focused,” Chapman says. “We do find that the conversations tend to be a lot more involved, a lot more structured.”

European LPs also like to be sent as much information as possible before the meeting in order to hone their questions and get as much as possible out of the exchange, says Guen.

“You need to make sure that the investor is very well-prepared, because based on that meeting they’re going to decide whether they’re going to do on-site due diligence,” he says.

4. Know your audience’s tax regime

Europe is not a monolith. Each country and each type of investor has unique tax and structural needs that GPs should plan for before even setting foot on the ground.

“The vehicle that you use to raise the money, the jurisdictions that they’re located in, and how your investments are going to be structured out of those vehicles needs to be determined to address where your investors are coming from,” says Richard Ginsberg, co-chair of DLA Piper’s fund formation practice group. “You would need different structures depending on which countries they reside in, and whether they’re taxable or tax-exempt.”

For example, a fund might be domiciled in the Cayman Islands because it is tax efficient for some European investors, but LPs from other countries might be subject to local laws that make a Caymans-based partnership much less tax efficient than an Alberta, Canada-based partnership. To effectively market a fund in Europe, GPs need to know who they want to approach and how they need to set up the fund so that it will appeal to those investors.

It’s also important to know how different countries tax different asset classes. Distressed debt funds have found it tough to attract many German LPs as tax treatment of the asset class “can be particularly harsh,” says Chapman.

Different countries in Europe also have different ways of taxing effectively connected income (ECI) generated in the US. ECI is generated when a foreign entity engages in a trade or business in the US – in the case of private equity ECI is generated whenever a fund invests in a flow-through entity such as a limited liability company. In Germany for instance, if a fund generates ECI, even if it is only on a small proportion of the portfolio, then the total return to the investor may be treated as income rather than as capital gains, leading to an effective tax rate of around 40 percent rather than 15



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percent, Chapman says.

“If you’re dealing with a UK pension plan versus a Spanish family office you might be dealing with a whole different set of regulatory and tax issues,” says Marco Masotti, a partner in Paul Weiss’s funds group.

For some investors the first question they will ask relates to tax treatment rather than investment strategy or track record, and if an appropriate answer is not forthcoming the conversation may well end there. US GPs need to take such factors into consideration ahead of travelling to Europe, and adapt their marketing strategy, and potentially their deal and fund structuring, accordingly.

5. Be alive to differing market terms

Finally, GPs need to recognize that market terms for European funds differ in significant areas from market terms in other regions. Masotti gives two prominent examples of this: first, a large portion of European funds return all of their investors’ capital before taking carry, whereas in the US carry is often distributed on a deal-by-deal basis with a clawback provision. Second, European funds are more likely to include no-fault divorce clauses that allow investors to remove a fund manager on a super-majority vote, he says, whereas in the US this is less common. European venture funds also tend to include a hurdle rate, whereas US funds do not, Ginsberg points out.

It’s tricky to decide just how much to rewrite your terms to accommodate your investors. Few managers make exceptions for individual investors, Masotti says, although if your LP base is mixed, then you might design a set of terms that will appeal to many constituencies.

“Based on my experience, managers do what there is market precedence for,” he says. “But generally if it’s a US manager than the terms will look more like a US fund, and if it’s a European manager it looks like a European fund.”

And at the end of the day, if your fund is good enough, European LPs will likely be willing to accept your terms.

“You will rarely hear ‘Well, that’s not how we do it in Europe’,” Ginsberg says.